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AUSTIN H. CARR, Editor,
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Editorial Comment

The Annual Meeting

Those who attended the thirty-sixth annual meeting of The Dominion Association of Chartered Accountants held in Halifax the last week of August consider it to have been one of the most important conventions held by the profession in Canada. As a report of the proceedings will be filed in due course in the office of every provincial Institute, reference is being made here to only a few of the matters which were considered by the meeting and which when developed and brought to fulfilment will, we believe, bring lasting benefits to the profession.

Following the discussion at last year's meeting in Vancouver on the subject of the education of the chartered accountant student—which was prompted by the reading of a well-prepared paper on the subject by Mr. Kris Mapp—a committee was named by the President to consider the whole question of a standardized programme of education and uniform examinations. The committee gave thought to these matters during the year with the result that following its report to the annual meeting at Halifax the Association recommended the adoption of the principle of uniform examinations throughout Canada. Time will be required, of course, to apply the principle in the primary, intermediate and final examinations, and for that reason

it may be expected that its execution at first will be confined to the subjects of the final examination with its gradual extension in coming years to all the subjects of the students' course of study.

From the pedagogical standpoint, a programme of education is planned primarily to enable the student during his five years of apprenticeship to become conversant with the whole field of study of the chartered accountant. The passing of examinations thereon, while necessary, is only incidental to that programme. Accordingly the annual meeting after hearing the interim report of the committee on education recommended that the committee be enlarged and that further consideration be given this year to a standardized syllabus of education for these five years of training.

The roundtable discussion on "Should the statutory form of the auditor's report to the shareholders be changed?" under the chairmanship of Kenneth W. Dalglish of Montreal, was one of the highlights of the convention. Here was a subject of vital interest to every member of the profession, and the large attendance and the general participation in the discussion bore evidence to that fact. We hope to publish in next month's issue a résumé of the discussion.

Research Studies

This year's meeting did not stop there. One of the objects or purposes of the Dominion Association is to act as a channel of information to its members in respect of all subjects which are relevant to the practice of the profession or which may contribute to the greater professional efficiency of the members. To carry out its functions the Association, according to its by-laws, is expected "to promote means of, and provide facilities for research into the history and the development of accounting generally, and in particular to consider to what extent and in what respect economic and social changes, legislation and legal decisions have affected or may affect the development of methods of accounting, and from time to time to examine the position of accounting theory and practice."

References have been made previously in these pages to the encouragement given by accounting societies in Great Britain, the United States and other countries to research

studies in accounting. The annual meeting this year directed the Executive Committee to give further consideration to this matter and to take such action as it might deem necessary towards the institution of a programme of research during the coming year.

*The Maritime
Provinces*

These glimpses of the annual meeting would not be complete without a word about the "Maritimes." Every month of the year has its attractions in the "Land of Evangeline" and August had choice gifts in store for the tourists in Nova Scotia at this season. Those visiting the three provinces by the sea for the first time discovered a peace, a charm, and a multitude of attractions of which they were not even faintly aware. With its inlets, its rivers, its hills and its valleys, Nova Scotia has natural beauties that are unsurpassed. The numerous points of historic interest about old Halifax, the facilities for healthful sport and of almost every type of outdoor exercise and amusement, and the friendliness and hospitality of the people, all contributed to making annual meeting week something to be cherished and long remembered.

*Auditors and
Provisions for
Depreciation*

An observation of some interest on the subject of depreciation appears in a recent issue of "The Accountant" (London). At the annual meeting of a company in Great Britain the chairman when making reference to the provision for depreciation in the accounts of his company stated that he regarded the subject of depreciation as a most important one. "I have had many discussions with accountants and auditors on these matters," he said, "and I must admit that I cannot see how members of the Institute of Chartered Accountants and the Society of Incorporated Accountants and Auditors can sign a balance sheet without investigating the provision for depreciation and referring to this in their report if necessary." And after calling attention to the satisfactory record of his company during the previous six years when the provision for depreciation was in excess of the amount "paid away in cash by way of dividends," he stated that there were companies which had not written off sufficient depreciation and had declared a profit and paid out in divi-

dends that which was really capital. "I feel that the Institute of Chartered Accountants and the Society of Incorporated Accountants and Auditors," he said, "should form a committee in order to strengthen their position in reporting on how depreciation has been dealt with in a company's accounts, and so avoid what has happened in so many cases in the past, namely, writing down of capital because the assets have not been properly depreciated."

At times the members of the profession in Canada have encountered somewhat similar opinions expressed by company officials and shareholders regarding the functions of the auditor and more particularly the attitude that should be assumed by him respecting the adequacy or the inadequacy of the provision for depreciation in the accounts of the company. The incident serves to bring up the old question of what are the duties of company auditors.

The tenor of the chairman's remarks "In Our Opinion" would seem to indicate that in his opinion the members of the profession are duty bound to determine the provision for depreciation—that in fact auditors are expected to take a firm stand with regard to the amount of depreciation that shall be provided for annually by companies in their accounts. Such an attitude of course is altogether foreign to the conditions under which auditors accept their engagement. According to the provisions of the statutes, they are appointed to examine the accounts of the company of which they are auditors and to report to the shareholders. In the words of Lord Justice Lindley, "It is no part of an auditor's duty to give advice either to directors or shareholders as to what they ought to do. . . . it is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that."

The provision for depreciation appearing in the balance sheet of the company is an item of very considerable importance. The determination thereof, however, is more a matter of engineering than of accounting. When examining the statement of a company, the purpose and the significance of the figure as allowance for depreciation must be kept in mind. The fixed assets on a cost basis in the

balance sheet are no indication of the worth of that particular enterprise.

The members of our profession will agree that this matter of depreciation cannot altogether rest there. While the primary responsibility for providing for depreciation belongs to the directors of the company, nevertheless the auditor under the provisions of the statutes is required to form an opinion respecting the accounts presented to him. How can he form this opinion without due inquiry into the facts? On this point we are privileged to quote the following from "The Accountant" of 13th August last, which sets forth the situation in a very clear way: "In forming that opinion the auditor's first step must be to ascertain what consideration has been given to the matter by the directors, who are the persons most nearly concerned, and on what data of fact that consideration has been based. He can then form the opinion either that the decision of the board is sound or that it is unsound. In the latter event a difficulty at once arises because the auditor himself has no technical equipment whereby he may direct his mind to a problem which lies outside the field of pure accounting. The situation usually resolves itself into a decision whether the auditor feels so sure of his ground that he can set his own uninstructed opinion against an apparently honest examination of the facts by the directors. In a border-line case the auditor will probably give the benefit of the doubt to honest directors, but in any other case he will be at liberty to inform the members in his report. We point out that, in ordinary cases, no auditor can go so far as to assess a concrete figure which he would regard as correct."

Audit Seekers In the general notes of our September issue a reference was made to the observations of a newspaper editor who we can presume had no particular interest in accountants or the accountancy profession. As a public spirited citizen, he referred to the responsibility resting upon councils throughout the country to select as auditors of the annual accounts of their municipalities accountants who possessed skill, experience and judgment—necessary qualifications for the important duty of auditor. The value of any audit, he observed, was in direct proportion to the ability and the qualifications of the person appointed to carry out the engagement. Such an appointment does not mean merely the checking of

figures. The citizens are entitled to a reasonable assurance that the taxes which they paid have been duly accounted for, and to have available to them at the year's end financial statements which show the condition of affairs of their municipality. Such assurance is possible only from an audit by competent and fully trained men.

It is on merit that chartered accountants are appointed to carry out responsible engagements. They are members of a profession; their offices can be ascertained from the telephone directory or on application to the Secretary of the provincial Institute of Chartered Accountants; they are not audit seekers.

Unfortunately any person in this country, with little or no knowledge whatever of accounting, can designate himself an "auditor" and be appointed to the responsible duty of examining public accounts. Unfortunately, too, when the term auditor is so indiscriminately applied and lightly used the public cannot expect to know how misleading the title has become. Think, then, of the chagrin with which members of our profession must have read the following news item which appeared in *The Globe and Mail* (Toronto) a few days ago:

29 AUDITORS ATTEND MEETING SEEKING JOBS
ABSENTEE GETS IT

Twenty-nine auditors were present at the . . . Township Council meeting yesterday, when selection of an auditor to examine the township books for six years previous to January 1, 1938, was made. . . . was the choice of Council, but he was not present. He will be asked to confer with the Council on the matter.

We are not aware of who these twenty-nine applicants were or their occupations. The action of the council in choosing as auditor one who was not present (and who we note is a member of our Association) can possibly be regarded as some assurance that professional dignity and merit will tend more and more to guide councils in their choice of specialists for the examination of the accounts of the municipality—the municipality, let it be said, from which the members of council have been elected to carry out its administration in an efficient and dignified manner.

PRESIDENT'S ADDRESS*

ON the fifteenth day of May 1902 an Act to Incorporate the Dominion Association of Chartered Accountants received its assent by the Governor General of Canada. At the annual meeting held in Vancouver in 1929 a suggestion was made that the time had arrived for the consideration of the establishment of a permanent secretariat. During the annual meeting held in the City of Halifax in 1930, the decision was reached whereby the Dominion Association would undertake the establishment of a permanent secretariat. Subsequently your Dominion Executive appointed Mr. Austin H. Carr, M.A., C.A., as its first permanent secretary. As today's meeting completes the cycle of annual meetings since that appointment, a brief review of the affairs of the Dominion Association during these years should be of interest. Mr. Carr's attendance at this year's annual meeting as secretary-treasurer of the Dominion Association completes his official representation at the annual meeting held in all the provinces, excepting Prince Edward Island. It will be recalled that at our annual meeting held in Vancouver a year ago, Prince Edward Island was included in the rotation of provinces for annual meetings of the Association.

In the year 1930 our total membership was 1,465. Today our membership is 2,220, an increase of 755. This typifies our growth and to some extent is also indicative of the progress that has been made. Those of you who were familiar with the operations of the Dominion Association prior to 1930 can appreciate the advances made by the comparisons with the operation of the Dominion Association today. In 1930 and prior years our Association was relatively only an Association in so far as the annual meetings were concerned, or as a former president very pertinently said, "Immediately after the annual meeting the books and records of the Dominion Association were packed in a trunk, shipped to the newly appointed Dominion president or his appointed secretary, where they often remained unopened until a few weeks prior to the next annual meeting."

*Address given by Frank A. Nightingale, C.A., President of The Dominion Association of Chartered Accountants, at the Thirty-Sixth Annual Meeting, Halifax, Nova Scotia, 24th August 1938.

Council meetings consisted of a meeting of council members held an hour or so prior to the general sessions of the annual meeting. Matters demanding the attention of the officials of the Dominion Association were attended to by the president or his local secretary. The transmitting of any information to the individual member of the Dominion Association was practically unknown. The publication of THE CANADIAN CHARTERED ACCOUNTANT was the only link between the individual members.

Contrast that situation with the operation of the Dominion Association today. Your executive committee appointed annually by the council and consisting of six members of the Association in various provinces is in constant communication through the secretary's office with the Provincial institutes and with members of the Dominion council. At least three meetings of the executive committee are held yearly. Your council convenes one and one-half days prior to the opening of the general sessions of the annual meeting, and a further council meeting is held at the close of the general sessions. Continuous contacts have been maintained with the Provincial institutes. There have been given to the individual practitioner much information pertaining to Dominion company matters, copies of income tax rulings, legal decisions respecting income tax and other subjects connected with his accounting work, summaries of recent amendments of tax acts and company acts, and information pertaining to special acts of the Provincial legislatures affecting accounting and auditing, also information on many other matters of concern to the public accountant. Through the advent of the permanent secretariat I believe our Provincial institutes have greater common interest than ever before.

During the past few years there has developed the practice of the Dominion President visiting as many of the Provincial institutes as possible during his term of office. Frankly I was very skeptical of the value of these visitations. I found, however, on my visits this year, a keen desire on the part of individual members to hear and to learn more about the other Provincial institutes and the developments through the Dominion office. I returned from my visits firmly convinced that it is not only desirable but it is very essential that contacts be made from time to time by the executive officers with the Provincial in-

stitutes. I believe one of the reasons of the success of the Dominion Association has been through the timely information given by my predecessors during their Provincial visitations.

We owe more to the founders of the Provincial institutes and the Dominion Association than we often want to realize. They had a vision and an ideal. I believe at this date we are working towards the culmination of that ideal, but the finality is still in the distance. We are very provincial in many matters but I sincerely hope that in the near future we shall arrive at some definite understanding whereby a member of the Dominion Association will not be recognized as a member of any particular Provincial institute but as a member of the Chartered Accountants' Association of Canada. I am not unmindful of the very happy reciprocal relations that do exist between the Provincial bodies. I have, however, an intense desire to have adopted a standardized educational programme wherein any possible comparisons from a technical viewpoint will not arise.

Progress of Recent Years

The accounting profession has made tremendous strides during the past few decades, but none has been more impressive than the advances made during the past eight to ten years. We have been in the fortunate position, as a result of economic conditions, of having thrust upon us duties which our forbears in their wildest dreams did not consider.

Questions have been raised from time to time regarding the field of activities of accountants. What are the auditor's duties and what are the auditor's responsibilities? The last ten years have been productive of some very interesting court decisions in these respects. We of the profession take pride in our progress, but we are also mindful that accountancy is not static but is the result or product of a long and continuous process of evolution, and we realize too that the evolution has not ended.

Some of the questions and matters requiring consideration are:

(a) Is the statutory power given auditors adequate to their responsibilities?

(b) Is the education of the accountant sufficient to equip him for the varied and highly skilled duties which he is called upon to perform?

(c) Has the accountant's contribution to industry been as extensive as the opportunities permit?

(d) Has the accountant made his contribution towards a better understanding or interpretation of government finances and its related subject, taxation?

(e) The interpretation and understanding of accounting terms.

The first question has particular reference to the auditor's statutory reports. The auditor is merely an instrument by which the shareholders may control the exercise by the directors of the responsibilities delegated to them. He is not concerned with the question of management or policy. As you all will recall from your reading, Lord Justice Lindley defined the auditor's statutory duty in the following words: "It is no part of an auditor's duty to give advice either to directors or shareholders as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably; it is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that."

The second question relates to the education of our students. During my association with the Dominion Association I have been impressed time and time again with the intense interest that has been displayed regarding this important subject. On my recent visit to the Provincial institutes I found that one of the major discussions at each institute was the education of the student body. In conformity with the instructions of the last annual meeting your executive committee appointed a special committee to consider this important subject. A report will be presented to you later in the session for consideration, and I am hopeful as a result of such report and subsequent discussion that we may be able to adopt some plan whereby

we shall have a standardized educational programme for students over the whole of the Dominion, and eventually to arrive at a plan whereby we can have standardized examinations.

The third and fourth questions have reference to the accountant's contribution to industry and the relative question of government financing and taxation. I merely mention them here today as belonging to the enlarging programme of our profession. These are questions that face us daily and are matters upon which in the future we shall have to give more earnest consideration.

The fifth matter relates to accounting terminology. In this connection I want to quote from the proceedings of a recent Australasian Congress of Accounting: "In every science the problem of definition and nomenclature is of fundamental importance. In none has it received less earnest consideration than in accountancy, and this fact has far reaching consequences and adversely affects progress both in technique and statistics of accountancy."

Generally speaking particular accounting terminology is marked by the following defects:

(a) The lack of uniformity in the sense in which similar or like words or terms are used by different Accountants or by different schools of accounting.

(b) The professional use or misuse of words and terms in a sense which is foreign to the accepted connotation of those words and terms in everyday speech.

(c) The use of several different terms to express the same idea. Many of the terms contained words which have been coined with little respect or regard to the principles which underlie our language.

(d) The lack of precision in the use of language.

When discussing this subject at the last International Congress on Accounting held in America, Lord Plender made the observation: "There are certain words in our language which are capable of many interpretations. They mean one thing to one person and quite another thing to someone else. They have one meaning under certain conditions and other meanings under different conditions. In the region of finance and accountancy I do not think that any word falls more completely into this category than the word *Profit*."

I must express, as a member of the Dominion Association, my personal appreciation of the effort commenced by a former executive committee in the formation of a committee representative of all the Provincial institutes to consider this important question of accounting terminology. I believe the work undertaken is one of the greatest individual efforts yet made. The reports of this committee have been received from time to time, and a further progress report will be presented later in the session. Mr. John Parton of Winnipeg is chairman of the committee on accounting terminology and to him the Dominion Association is deeply indebted. I wish to express my thanks to Mr. Parton and to all the members of his committee.

Last year your executive committee after careful consideration and consultation with the editorial committee decided to set aside a portion of our official publication, THE CANADIAN CHARTERED ACCOUNTANT for the use of the terminology committee, and in this manner to advise and inform the individual members of the progress being made in their studies of this subject. Recently there has been issued to all members in loose-leaf form the beginning of a dictionary of accounting terms for Canadian practice. On the completion of this dictionary let us hope that we in Canada will have an accounting language understood by all.

Functions and Standards

It has been agreed and perhaps with a little bit of braggadocio that the accounting profession is the oldest profession in the world. Be that as it may, the establishment of the first Chartered Accountants' Association in Great Britain was in 1854. From that time until the present, as stated earlier in this address, our advance has been rapid; the greatest rapidity having been noted during the past few years. We owe much to the wisdom and foresight of our pioneers who founded this profession upon a code of ethics, adherence to which has in no small measure contributed to the position we occupy today.

In former days accountants did not have any particular standing in the community. Their services were only required when questions of suspect, fraud, irregularities or insolvency occurred. Later, when business grew and it became necessary to call in an accountant, often pressure was brought to bear to get rid of him as quickly as pos-

sible. Conditions, however, have changed and today irrespective of the statutory obligations of corporations the professional accountant's advice and services are in very considerable demand. Among his other qualifications he stands known and respected for his ability to state in his report exactly the condition in which he finds the affairs of the client under review; moreover, irrespective of personal feelings he does not deviate from his duty.

Our predecessors founded the accounting profession on the basis of freedom of thought and expression and truth. They had the vision to search, to find and to tell the truth about accounts. We today have the same vision, and as long as we maintain our absolute independence we shall continue to have the respect and confidence of all; but if anyone outside of the profession, be it governmental, client or friend, is stronger than we are and is enabled to influence a statement or a report against our better judgment, then from that moment our profession will begin to deteriorate.

The accounting profession exists as a means of public service. The distinction which separates the profession from a mere means of livelihood is that the profession is accountable to standards of public interest and beyond the compensation of client. There are many matters regarding which our advice is sought. We must continue to serve the public interest on matters that come within our province, being honest with ourselves, with well balanced judgment and not afraid of expressing our opinion after careful and thorough enquiry; or as Colonel Montgomery of the American Institute of Accountants expressed it last year in his presidential address: 'In order to tell the truth there must be some detachment from one's immediate environment, from the opinion of neighbours, from ambition, money, fame, power, comfort, security and ease.' It is this need of honest and independent expression that today has given the accountant his prestige. By keeping ourselves free from any political or factional control, or from any intimidations; and at all times retaining the courage to fulfil our independent public function, we shall continue to add prestige to our Association and to ourselves.

Our advancement, as I have already stated, has been rapid. An analysis of the first volume of "The Accountant" (London) which was published in 1874, shows that ninety-

four per cent. of its space was devoted to bankruptcy law and practice. Make a comparison with the subject matter of discussions at the last International Congress on Accounting in 1933 which contained in part such subjects as international finances, exchange fluctuations, holding and subsidiary corporations, accountants as an aid to commerce, mechanical accounting, auditors' responsibilities, and depreciation and obsolescence; or with the subject matter of the International Congress on Accounting to be held in Berlin, Germany, next month, such as business planning, audit of annual accounts, company law, auditing of combines, auditing by and for tax authorities, and methods of computing costs and control of prices by public authorities.

What of the Future?

At this gathering of members of our profession from Halifax to Vancouver, we may well ask "What of the Future?"

After examining the various comments made from time to time by clients and by guest speakers at our various public functions, we are forced to the opinion that their chief problems appear to be:

- (a) The extent of their obligations to the taxing authorities,
- (b) The safeguarding of their shares in public companies,
- (c) The understanding of financial statements, and
- (d) The understanding of auditors' reports.

It is recognized that there is a greater need in the ordinary mass mind for a clearer understanding of financial statements. This need is being presented by most financial writers. Should not we facilitate such clarification, particularly with reference to earnings and full disclosures of all essentials?

I am hopeful that during coming years we shall more fully consider these matters and determine the establishment of an accounting research department in connection with our Secretary's office. The results of such research endeavours will be very beneficial and will enable the head office of our Association to disseminate to our members information that will tend towards a better understanding on many subjects, and perhaps a clearer understanding of financial statements. The question of auditors' reports is

the subject matter of a roundtable discussion to take place later in the session; I shall not, therefore, make further reference to the subject at this time.

We must all realize that the public forms its opinions by contact with the individual members of our profession and that it is the character of the individual which upholds the tradition and prestige of our calling. The continual raising of our standards, then, the maintenance of our independence, the living up to the ideals of our profession, the ability to tell the truth about accounts, and the education of our students, are among the essential matters for the consideration of our association.

The Unemployment Problem

May I call your attention to a matter of national importance in which we as members of a great profession should be concerned?

During the past year we have been the witnesses of many events that are doubtless making history. It is recognized there has been little slackening of the nationalistic spirit. We individual members of the British Empire have sometimes felt that this nationalistic spirit at times has bordered close upon intolerance. With the exception of Great Britain, almost every nation in Europe regards its neighbours as potential enemies and trade rivals. The old doctrine of "might is right" is being proclaimed and this is much in evidence by the revival of the building of navies, great armies, new instruments of war, and rearmament programmes.

Because of activities in these directions, certain countries appear to have solved the unemployment problem. There is no doubt that the employment of young men in military training has reduced the strain in the industrial field. Can we, however, feel that the future of these young men has been clarified? I am afraid not.

Dealing particularly with the unemployment situation in this country, one is convinced that much effort has been expended in attempting to find a palliative while the real solution to this problem remains to be found. In the early days of the so-called depression it was quite evident that temporary measures of relief were expedient, but does it not appear to many of you that the measures then used are not and have not been applicable to Canada during

the intervening years? I know full well the phrase so often used that we are a "large country with a small population containing unlimited wealth and natural resources, and that no one should suffer." What have we done about it? We have unemployment, great distress, dissatisfied citizens, rumors and counter-rumors, and we have many people starving both physically and mentally. I am distressed by the outlook for tomorrow. There is the pathetic sight of young men who have not learned a trade or calling. About us we see youth who cannot obtain any gainful employment. Young people, because of their appearance on the scene at this particular time, are today unemployed and never had employment. What of the future? Does it mean that the next decades are going to witness strife, unrest and the tearing down of all that the past has built up? I believe that our statesmen and citizens must be more impressed than ever before with the fact that some scheme must be instituted to enable the boys and girls leaving school to receive a chance in life and to be taught to have proper bearing, poise and purpose.

The statement may be a surprise to us, but it is a fact that many employers today are experiencing difficulty in obtaining skilled labour. Why? Among other reasons, two should be noted particularly, namely, that those who have been out of employment have lost their skill and their desire and are out of touch with the changes in industry; also that no adequate provision has been made for the training of the younger men.

Does it not appeal to reason that during the periods of depression training schools should be provided and equipped to enable workers to maintain their efficiency whilst unemployed and to train the available youth? By this means a supply of efficient workers would always be available.

The relief dole is the breeding basket of unrest and associated evils which if not alleviated will become the fore-runner of upheavals in the national and economic life of Canada. One of Canada's great problems is its small population and one of its greatest dangers is its sparsely peopled territory. I do not want to dwell in the realm of impossibilities, but when we look at the situation that exists in Europe and the Far East, the future holds no rosy dream for any unsettled or sparsely settled countries. Nations

with surplus populations would colonize Canada immediately if permission were given. It does not appear consistent with the economic strength of the British Empire that Canada should be allowed to remain dormant, but by a carefully planned and well financed immigration policy it should be possible to develop this country in such a way that by the very essence of such policy the unemployment problem will be relieved. Do not misunderstand me. I do not mean a migration policy that merely groups fresh people around the already existing markets of the large cities, but rather the settlement of the vast unpopulated districts. This country needs population for the utilization of its resources both natural and manufactured. As an integral part of the British Empire cannot such a scheme be instituted by collaboration between the Motherland and our Dominion government?

I make no apology for presenting this matter at this time. We have a duty to our fellowmen. When we have dire want in the midst of plenty; when we have the younger generation growing up without chart or compass; when we observe the insidious dangers of men losing their sense of values, losing their capacity to think, losing their hold of things they formerly thought worth while, it becomes the obligation of every individual to give serious thought to those matters.

Unemployment in Canada should not exist. The future of our nation and of your families and mine, depends to a large degree upon the solution of this problem. In so far as the accounting profession is concerned we are extremely involved. We flourish as business flourishes. Any tendency towards unemployment, any recession or upheaval in business is not advantageous. When our citizens, as well as the citizens of other countries suffer from unemployment, heavy taxes, unstable exchange, restriction of industry and the associated economic upheavals, we suffer also. Therefore, may I plead with you to consider seriously this problem of unemployment, bringing to bear upon it the unbiased, independent, well-balanced judgment that you use in the affairs and assignments of your clients.

AN ADDRESS

Given at a luncheon meeting 25th August 1938 in the Lord Nelson Hotel, Halifax, by George Cochrane, A.C.A., New York, representative of the Institute of Chartered Accountants in England and Wales to the annual meeting of The Dominion Association of Chartered Accountants.

Mr. President, Ladies and Gentlemen:

I want, at the outset of what, I hope, will not be too trying a talk, to say how appreciative I am of the honour which has been conferred upon me by being invited to represent the Institute of Chartered Accountants in England and Wales at this meeting of the Dominion Association. Particularly am I honored, because, as well as being an English chartered accountant, I am also a member of this Dominion Association.

At a meeting of this character I did not feel that I was called upon to deal with technical matters—I'm certain that the ladies are fully in accord with this thought. In fact, the less technical my remarks will be, the more certain I am of their approval. Be that as it may, certain things do affect us professionally and I don't think that the opportunity should pass without mentioning some of them.

As these remarks were not the result of consultation with other speakers it will be found that in some respects I may repeat what has already been said. You will of course understand that my representation of the English Institute is limited to my attendance here and any views I may hereafter express are entirely my own.

It has been recently stated by such an eminent accountant as Mr. George O. May that "Accountants have talked in terms of certainty and complete assurance where only an informed judgment . . . could in fact be provided . . ." Accounting is not an exact science and therefore it is not surprising that more than one opinion may be expressed as a result of an examination of the same set of figures by different qualified accountants. It is highly desirable, therefore, that we should, from time to time, meet with a view to hearing the different opinions and endeavouring to reconcile those differences.

Thought the world over is slowly being tainted these days because of a surge of nationalism as a creed in a slightly harried and restive universal scheme. The em-

phasizing of this nationalism should not affect accounting. The principles of accounting, no matter where applied or in what currency, expressed by competent accountants are the same the world over. And the accounts with which we deal know no limiting frontiers, no differences arising from race or language; accounts, properly framed, can be understood by the informed everywhere.

Within the turmoil that is Europe today, every agency disseminating knowledge and the professions associated with those agencies have been curtailed or affected by regional variations in government. The law, the sciences, the liberal arts—even medicine have been victimized. As a result, they have suffered tremendously because of the national drag on their professional altruism. Our profession, almost alone has not been affected by drastic change and remains universal in its activities. When, in the course of events, restrictions on a profession seem imminent, and which eventually are built up against the profession, a gathering of this kind should publicly deplore those restrictions.

The value of our services as professional accountants is due largely to our complete independence of action and judgment. And anything that tends to restrict such freedom will result in a limitation of our usefulness. On the other hand, that usefulness can only continue with the proper exercise of our methods and repeated criticism of our standards such as takes place at such a meeting as this.

In Great Britain, the Commonwealths associated with her and in the United States, in fact wherever the chartered accountant has practised, we have to date been able to build up, and keep our profession on a high level of professional attainment and ethical requirement.

In Great Britain and the United States, government has acknowledged the value of and contributions made by the body of accountants of these countries and have seen fit to call upon members of our profession for activities extra-curricular to their domains.

As a visitor to England from time to time, I have been considerably impressed by the extent to which the British government utilizes the services of professional accountants to assist in fact finding on commissions and at departmental inquiries dealing with matters not immediately con-

nected with accounting. Such services are honorary and are given, willingly and generously, as a public duty.

As representative of such services to the government let us look at a partial list of such appointments as reported by the President in the annual report of the English Institute for the year 1937:—

Tithe Redemption Commission.

Arrears Investigation Committee under Tithes Act, 1936.

Royal Commission on Local Government on Tyneside.

Commission to investigate Jamaica Banana Industry.

Air Ministry Advisory Committee on Prices of Aircraft Supplies.

Even in my own country, the United States during the last few years, there has been a marked increase in the number of occasions when the national government has called upon committees of the American Institute of Accountants and of the various State societies to consult and advise. And, while the occasions have not been anything like as frequent, or the enquiries as extensive as those in Great Britain, nevertheless the tendency is one which should be encouraged. I do not know to what extent the Dominion or Provincial governments call upon you to assist or advise in matters for which you are particularly fitted, but I am sure that it should be more generally known that services such as I have indicated will be willingly undertaken by any of us who may be called upon.

Of course, governments and business have been allied since time immemorial. The bonds tying the two entities were sometimes lax, as in countries which adopted the extreme *laissez faire* attitude and then again there were those nations, where governmental control of business amounted to a practical monopoly. Very often, the mutual understanding existing between government and industry has been strained. In bureaucratic governments that strain although subsurface, is nevertheless, definite and subversive. Such bureaucratic interference, a harmful influence at best, incurs distrust and ill-feeling.

In the more enlightened countries business is conducted on the general assumption, that business itself is the concerted result of individual endeavour and foresight. Occasionally, however, business has been hampered, even in

democratic countries, by the exigencies of laws and economic conditions, which like other natural laws, have moved in cycles.

When such exigencies have arisen, as has been the case in the United States during the past few years—when legislation has sometimes clashed with vested business interests—friction between government and business has become more than just noticeable. The factors that incurred this friction were largely due to the uncertainty on the part of business and industrial executives as to what governments would do next as far as industrial legislation was concerned.

Sooner or later, however, business and government come to an understanding, and differences are considered and assessed . . . And it is to this end that our profession may advantageously intervene. Business does not accept as being right everything the government proposes but judges government plans with less suspicion while, on the other hand, government usually loses the general conviction that business is primarily selfish, seeing only its own industrial viewpoint, and eventually concludes that business is as much interested in public welfare as the government.

How different, however, is the case in the present day totalitarian state! There is no such compatible relationship. A dictator or his puppet declares that such is the law and forthwith he applies it to business and industry. Complementary professions, like accounting, must of necessity fall in line with any edict issued by the government. There is no redress for business or the professions.

I am sure you will all agree with me that the practice of our profession in such countries and under such conditions would be impossible, and therefore we must deprecate encroachment on the liberties of others as well as on those of ourselves, if for no other reason than a selfish one. Nor should we initiate selfish restrictive rules, because it seems to me that others less well informed and less well intentioned are prone to follow our lead and thus ultimately build up such conditions that we shall find ourselves entirely unable to practice in the only manner possible, namely with absolute freedom.

Imagine, if you will, a small businessmen's association of Munich attempting to show the need for governmental assistance to such an august body as rules German eco-

nomics and finance! In America, England and this Dominion such procedure is not only possible but is now actual case history. The manufacturers of Glasgow, Liverpool, Leeds and Manchester have a real voice in their government. The small retailer and his accountant, of New York, Rochester, Denver and Hollywood, to mention a few, visited Washington last February and painted in their own terms, before our legislators, a sharp vignette of business conditions as they existed for them. And, mind you, in no uncertain terms. Then, they suggested reforms or possible legislation, which would release, at least as far as they were concerned, the stalled wheels of industrial progress. They were not seeking soothsayers, nor were they expecting miracles, but, strangely enough, a mutual understanding was reached and the relief of the tension is a possibility.

May we not assume that the confidence placed in the profession all over the world in the face of the changing nature of the times, is not merely accidental, but is due to the high professional ideals upon which our predecessors have built and that we are determined to maintain.

For years I have been interested in the subject of students' societies as an adjunct to the training of those who will follow us in the practice of our profession. As you are aware, apprenticeship is a requirement of the British Societies, but in addition in all the large centres there are students' societies at which lectures and debates are conducted. Many of the lectures are given by practitioners, and members of the senior societies are always present to guide and direct.

With us in the United States, all the training, other than that received in the ordinary course of work in an accountant's office, is received in schools and universities, where the teachers are usually men who devote the whole of their time to teaching, although in some schools some of the teachers also practise professionally. I understand that your system is somewhat similar to ours in the United States, although I note from the remarks made at meetings I have attended during this convention that some parts of the Dominion already have students' societies.

There has recently been organized in New York a series of meetings known as the Discussion Group at which leading members of the profession open discussions on subjects of interest and the attendance at these meetings is made

up largely of staff assistants. It is hoped that this movement will grow and become in effect a students' group.

The point I wish to make is that under the system in force in Britain the practitioner's point of view and the ethics he so well understands can be continuously passed on to the student in a manner and to an extent which does not seem possible through school training.

I well remember, for instance, in my own days as a student, that seldom was a legal subject lectured upon or debated that it was not pointed out by some senior who took part in the subsequent discussion that we were learning law not to enable us to give legal advice to clients, but to make us more understanding and intelligent clients when we found it necessary to be advised by lawyers. Had this point of view been more fully understood I am sure that much of the opposition from the legal fraternity which is now being met in certain directions in our practice in the United States would have been avoided.

Another activity to which I recommend your attention is the Research Association which has been organized by a group of accountants and business men in England.

Because our profession has only been organized for so comparatively short a time we have perhaps been so busy building and consolidating that organization that research has not been possible. Now, however, a lead has been given by the accountants in London and various phases of our work are to receive closer investigation.

Part of the material for such research will be obtained from the various accounting firms who, examining their working papers, can compile data without of course disclosing the source. I have noted with considerable interest that you have already arranged to participate financially in research to be conducted by one of your universities, but may I be allowed to ask you to consider whether research such as this should be assisted only financially or whether it would not be better for our members to be represented as actual participators in the work and direction of such investigations?

Finally may I thank you for your fortitude in sitting through this address and reiterate my profound pleasure at being allowed to greet you on behalf of the English Institute and being the means of conveying their continued good wishes to their brethren in the Dominion of Canada.

THE ADMINISTRATION OF THE CANADIAN INCOME TAX LAW*

By C. Fraser Elliott, K.C., Ottawa

TO ADMINISTER the Canadian Income Tax Law, Canada is divided into nineteen districts. The districts are irregular in shape and of different areas. Their shape was influenced by the desire to have a district follow the railway lines. Recognition was given also to the main centres and provinces. In the beginning, sub-offices were required to serve the people, but experience has shown that they are not a necessity and most of them have been closed. The districts have remained unchanged for about ten years. Each is in charge of an inspector directly responsible to Ottawa.

The amount of the revenue collected in each district is not a true criterion of the wealth of the particular district. Some small districts have the head office of a few large corporations in them. The district of London, Ontario, for instance, has in it such companies as the Ford Motor Car and Imperial Oil. Their income is derived from world-wide sources. Consequently on a revenue collection basis the district appears to have more wealth in it than it really has. It is the same with Toronto and Montreal.

Usually a company files and pays its tax in the district where it has its head office, although the business of the company may be located in some other district. For example, the mines of northern Ontario are located in the Ottawa district but their corporate head offices are in Toronto, so they file and pay their taxes there. There is not any compulsion to pay in any particular district. Districts are established for the convenience of the public and returns can be filed in the district most convenient for the taxpayer.

The staff employed in the Income Tax Division has generally numbered somewhat over 1,200 and is now 1,258, composed of about 30 senior officials, including inspectors; 360 assessors and auditors; and the balance, clerks in the various grades.

The cost of collection has steadily declined from about 3.5 per cent. to its present level of 1.9 per cent. This has

*An address given by the Commissioner of Income Tax, Ottawa, at the 1938 annual meeting of the Canadian Political Science Association.

been occasioned by three factors: (1) the public have become more educated in the performance of their statutory duties; (2) revenues have increased; (3) internal efficiency has increased and internal economies have been effected. In the first ten days of May some \$90,000,000 was collected and transmitted to Ottawa. The revenues up to 1934 averaged something over \$60,000,000 per year. Thereafter the collections increased by about \$20,000,000 annually, until last year \$120,000,000 was collected. This year it is estimated there will be collected about \$135,000,000. Since 1932 the general rates have not been changed.¹ However, surtax on individual investment income was imposed in 1934² and the average yearly collection therefrom has been under \$3,000,000.

The general Income Tax forms used by the public fall under two headings: (1) those forms in which they declare their own personal incomes and in respect of which they pay a tax,³ viz., T.1 for the use of individuals and T.2 for the use of corporations;⁴ and (2) those forms in which they supply information of income paid to others,⁵ viz., T.3 for the use of trustees distributing income to beneficiaries, T.4 for reporting salaries, T.5 for reporting dividends, and T.609 for reporting interest from registered bonds.

The statutory responsibility for securing and filing all forms rests upon the taxpayer. They can be procured from inspectors of Income Tax, postmasters, and banks. As a special service to corporations, they are supplied by mail with all appropriate forms.

Then there are Ownership Certificates,⁶ introduced in 1933. All persons cashing bearer coupons or warrants must sign an Ownership Certificate and thereon declare their name, address, and the amount of the coupon, otherwise they cannot cash their coupon.⁷ These the banks collect and, in alphabetical order, lodge with the appropriate inspector. About 1,400,000 Ownership Certificates are received each year. The Ownership Certificates belonging to

¹23-24 Geo. V, c. 41.

²25-26 Geo. V, c. 40.

³Revised Statutes of Canada, 1927, c. 97 (hereafter referred to as R.S.C.), s. 33.

⁴R.S.C., s. 35(2).

⁵R.S.C., s. 39.

⁶23-24 Geo. V, c. 41, s. 15.

⁷23-24 Geo. V, c. 41, s. 39A.

each taxpayer are segregated to that taxpayer's file and checked with his declaration of income. Special arrangements have been made with brokers and trust companies whereby they, as nominees, may cash the bearer coupons without an Ownership Certificate, but they themselves, on the appropriate form, must declare the name and address of their clients, and the amount payable to each.

Salaries, dividends, and other like information are segregated and posted to the Information or T.12 Card in the Tax Roll Section of each district office. Information received in one district office that is applicable to a taxpayer resident in another district is transmitted, through Head Office, to the district concerned and similarly finds its way to the Information T.12 Card of the taxpayer, so that a dividend paid on the west coast to a resident on the east coast is covered as effectively as is a dividend paid by an Ottawa company to an Ottawa resident.

The number of Income Tax returns filed is about 400,000, of which some 215,000 are taxable; the latter are divided as follows: individuals, 200,000; and corporations, 15,000. Now what happens to an Income Tax return when it is received into the system?

Income Tax returns are filed in duplicate. They are counted and segregated into three lots: (1) those that have been paid in full, according to the taxpayer's estimate; (2) those with partial payments; and (3) those with no payment at all. The three parts are tabulated for statistical purposes. They are then transferred to the Tax Roll Section and recorded as having been received, on the Information or T.12 Card. These Information T.12 Cards, on one side have the name of the taxpayer with a year column in which to record the receipt of the annual return; on the other side is recorded accumulated information received from various sources. The cards corresponding to the returns received are then removed to a separate cabinet, and thus the cards of taxpayers who are delinquent in filing their return become self-evident. Thereafter, the returns are filed under the heading of "unfinished work" and throughout the year distributed to the assessing staff in the inspector's office.

An assessor, with the Information T.12 Card available, checks the return and passes it through the hands of the chief assessor into the hands of the Independent Audit Review Board. Each Independent Audit Review Board con-

sists of three assessors. It has a circulating membership. One member is replaced each year. If the assessment is found satisfactory by the Independent Audit Review Board, it is transmitted to Head Office for final approval by Head Office auditors. If there approved, it is returned to the district inspector. It will be observed that every assessment is passed on by two assessors miles apart and as well by the Independent Audit Review Board. A district assessor is not permitted to assess a return for more than three years in succession. At least once every three years an auditor from the field must visit the place of business of the taxpayer.

When the assessed Income Tax return is received back again in the district office, it is handed to the Accounting Section. This section compiles therefrom the Notice of Assessment and the return is thereafter filed under the heading of "finished work." There it remains for a period of three years, after which it is transferred to storage. The Notice of Assessment goes to, and is followed up by, the Collection Section.

Money is received by cash or cheque, with the return. Letters are opened under supervision in a sorting room and sorted so far as possible according to the banks on which the cheques are drawn. When cash is enclosed, the amount is initialed on the return by two persons. The returns with the remittances attached are given to the cashier who makes a book record of the amount of the remittance and the serial number of the receipt to be issued. He then issues the receipt in triplicate. The triplicate copy is pasted to the taxpayer's return. The original is set to one side to be mailed to the taxpayer as soon as all the cheques have been honoured. The duplicate is sent to the Accounting Section for the preparation of Head Office statements and ledger records.

The cashier receives two things for which he must account: (1) moneys; (2) receipts, serially numbered. The money is accounted for in one direction and the duplicate receipts are accounted for in another direction. The cash and the continuity of the serial receipt numbers are audited daily by internal auditors.

As stated, the duplicate receipts are transferred to the Accounting Section. There they are used to prepare a detailed statement of the name, address, amount of money

received from each taxpayer, and the serial number of the receipt issued. The duplicate receipts are sent to Head Office with the original statement prepared by the Accounting Section. At Head Office the duplicate receipts are numerically filed and this numerical filing is checked with the Head Office records of the receipts originally issued to the inspectors, so that the receipts issued and the receipts returned are fully checked by actual examination and if any particular serial number is missing it becomes self-evident.

The total of such statement, before being sent to Head Office by the Accounting Section, is verified by the accountant with the cashier's records of the money received by him. The cashier deposits the cheques in the appropriate banks and purchases Receiver General Drafts. These drafts also accompany the accountant's statement to Head Office. The drafts in turn must equal the total of the cashier's records and also the sum of the receipts. At Head Office the statement as to total is recorded in a control account while the Receiver General Drafts are passed on to the Department of Finance and by them to the Bank of Canada.

District Offices maintain a ledger account for each taxpayer. Moneys received are credited to the taxpayer's ledger account while assessments issued are charged to the account. The District Office also maintains general ledger control accounts which are balanced six times a year as against the individual ledger entries. Head Office, on the other hand, charges the District Office with assessments approved at Head Office and credits the District Office with moneys received at Head Office in the form of bank drafts. Head Office and the District Office accounts are also balanced six times a year.

The foregoing very briefly describes the receipt of money, its disposal, its audit, and the accounts in connection therewith. In the result, over the past fifteen years we have collected over one billion dollars without the loss of a single cent.

As to revenue that remains unpaid one month after the issue of the Notice of Assessment, the records thereof are transferred to the Collection Section which maintains an appropriate card system. This section issues collection letters, and if any account remains unpaid it is transferred to the Legal Section which issues a formal demand indicating legal procedure on failure to pay. Continued failure to pay

brings on two possible actions: (1) the equivalent of garnishee proceedings, wherein the Crown issues a demand upon the taxpayer's creditor to pay to the Crown that which but for the demand would be paid to the taxpayer;⁸ and (2) inasmuch as the tax is not in dispute, there having been no appeal lodged, and is unquestionably a debt due the Crown, speedy procedure for securing Exchequer Court judgment is available on certification as to non-payment of the tax. The certificate as to non-payment is lodged with the Court and thereupon becomes the equivalent of judgment, and all procedures may be taken thereafter as if a formal judgment had been secured.⁹ The foregoing procedure affords a satisfactory means of collecting the revenue. Indeed, all revenues are collected with the exception of those incidental cases where the taxpayer is deceased leaving no estate; goes into bankruptcy and does not pay 100 cents on the dollar; or has left the country and is beyond our jurisdiction, leaving no assets in Canada upon which to realize.

The required statistics are compiled in code in the District Offices and transferred in such code to Head Office. At the end of the year, Head Office is in a position to state the amount collected, the number of taxpayers, and all appropriate information. The Dominion Bureau of Statistics publish these statistics annually.

That Dominion Income Tax forms and procedure seem to have found satisfaction with taxpayers and the public in general is evidenced by the fact that the province of Ontario in 1935 asked the Dominion if the same forms and procedure could be adapted for the collection of Ontario revenue under the Ontario Income Tax law.

In 1936, the collection of the Ontario revenue was undertaken by the Dominion administration, the outstanding features being that the Ontario law was enacted in reasonable conformity with the Dominion law, and this was particularly requested in respect of the definition of income, so that the determination of taxable income under the Dominion Act would *ipso facto* determine the income under the Ontario Act. Exemptions, allowances, and special deductions, different from those allowed under the Dominion Act, were not matters of great concern in determining provincial

⁸R.S.C., s. 72.

⁹R.S.C., s. 71.

assessments for it meant simply isolated and stated deductions from a basic income. However, the definition and determination of income should be the same under both Acts. The procedure and forms indicated above for the Dominion laws have been satisfactorily adapted to the needs of Ontario administration. The two laws have been made to function satisfactorily by the public using single Income Tax forms. Single forms performing joint functions are also used satisfactorily in the internal administration. The Ontario collections are, of course, segregated from the Dominion collections, and are accounted for separately and remitted to the province of Ontario through the Department of Finance.

The collection for Ontario having passed beyond the experimental stage, the provinces of Manitoba and Prince Edward Island this year came into the scheme of Dominion administration for dual purposes. The Income Tax Division is now administering for three of Canada's provinces—Manitoba, Prince Edward Island, and Ontario.

Interpretation of the Law

While the foregoing deals principally with the mechanical and physical, the important, or at least the more interesting, is the interpretation of the law and facts.

Assessing is our most important function. Two things must be known: (1) the gross income of the taxpayer, and (2) his chief occupation or business. Observe that income is defined.¹⁰ It would probably be better if it were not. However, it is defined and the definition falls into two parts: salary and similar fixed annual income; and profits from a trade, business, or profession. The first indicates a stated amount, the second is the result of calculating and co-relating many things. Keeping this in mind, observe the following statutory limitation. The income shall be not less than the income from the taxpayer's chief occupation, trade, business, or calling. This means we must determine the chief business or calling. Two or three major activities may be combined and called the chief business or calling.¹¹ It follows that you may be poorer at the end of the year, yet pay a tax.¹² For example, take the case of a salaried man—

¹⁰R.S.C., s. 3.

¹¹R.S.C., s. 10.

¹²R.S.C., s. 10.

the earning of his salary is his chief occupation. If he has investments and the carrying charges exceed his dividends and interest, nevertheless he pays on his salary. If he tries to run a secondary business or agency, and loses, nevertheless he pays on his salary. His income shall not be less than from his chief source. If he owns revenue-bearing real estate and expenses exceed rents, he pays on his salary.

Our law is as its name states—an Income Tax law. While it separates certain incomes and income losses, it never departs from taxing true income. It does not attempt to tax capital gains or allow such losses. In 1929, there was a temptation to tax speculative gains by amendment. The wisdom of not doing so was shown subsequently by speculative losses. If the gains had been taxed, the losses would have been allowed.

Basing the tax on the chief source of income ensures stability to the Government revenue. While it may appear unfair it really is not. The principle is this: first you have an income and that must bear tax before it is applied and jeopardized in other directions. Two persons are in like businesses. The one spends all his income on raising a large family. The other uses his income in some secondary business which incurs a loss. It is right that they should both bear the same tax.

Many adjustments in returns are caused by persons claiming losses in secondary activities against their chief source of income. The present Income Tax forms do not show the distinction clearly as perhaps they should. This was probably caused because the forms were compiled with the following objectives in mind: (1) to secure a complete declaration of gross income from all sources and without segregation; (2) to secure complete personal information and proof of all allowances and exemptions claimed so that no further information need be requested from the taxpayer; (3) that calculation of the self-imposed tax may be made by the taxpayer on his own conception of the law and his net income thereunder; (4) to make it as simple as possible. In this way we hope to accomplish the bulk of our business by one return, one payment, one assessment, and thus close the file and await another year. That, I may say, is substantially what happens.

Now a word about the desire to make it as "simple as possible." Neither the law, the facts, nor the forms can

ever really be simple. Income Tax does not lend itself to simplicity. It is a study for everyone, even the experts. While recently in Washington, officials there stated that our form appeared to them difficult. My thought was quite the reverse, namely ours is simple, theirs complicated. Neither thought is correct. The subject and the forms must be studied. We must become familiar with the law and the forms if they are ever to become even partially simple. It is impossible to impose Income Tax in a country where the people are not educated. Income Tax is essentially an intelligent people's law for the raising of revenue in an intelligent manner. Business forms are not simple. Business records are complicated. We suggest that one form to reflect one year's business and personal status, without more ado, is necessarily not a simple document. However, we branched off into this consideration of "simplicity" when we were really dealing with the definition of "income" and its interpretation.

Avoidance Methods and Remedial Measures

Many persons try so to arrange their affairs that in lieu of receiving income as such, the same amount is received as capital. This, of course, should be stopped; all should be treated alike. England does not tax capital gains as the United States do under an Income Tax measure. Therefore, we follow the English court decisions in practice and not the United States decisions. The English courts said stock dividends were not "income;" that a company with accumulated earnings on winding up did not distribute earnings or income, only assets, and assets were non-taxable capital. These decisions occasioned some early amendments. For instance, in 1919 the Canadian statute was made to declare that "dividends shall include 'stock' dividends."¹³

Volumes have been written on "stock dividends," creating two bits of paper where formerly there was but one whereby the two represented the same assets as the former one. That is true, but the assets are represented in a different form. The former corporate earned surplus was converted into paid-up share capital. The surplus should be taxed at the time it loses its character or is put out of the channel of income. That time was when the stock dividend was declared. The stock dividend created newly paid-up

¹³10-11 Geo. V, c. 49, s. 1; R.S.C., s. 2(b).

share capital. Paid-up share capital on being redeemed is not taxable income. Therefore in this country it was thought wise by those who wished to avoid tax, before distributing corporate earnings to capitalize them and then distribute the same assets under a non-taxable description. Such procedure was stopped.

The English law also decided that on winding up, the distribution of assets did not create income. The aliquot share of the corporate assets was substituted in the hands of the shareholder for his surrendered share. In equity he had nothing more after than before the winding up. In Canada we say the earnings of a company are taxable when they reach the hands of a shareholder, either by normal dividend or any other method or under any other name. In 1921 we amended the law to provide that on the winding up, the distribution in any form shall be deemed to be a dividend to the extent that the company had on hand undistributed earnings as surplus.¹⁴

Here is a very simple device. In 1920 companies by their accounting methods sought to average their profits, i.e., out of a good year they would set aside a reserve and declare as profits the balance. The law intended to tax profits in the year earned. So, for tax purposes, amounts transferred to reserve account were not allowed as a deduction. The business advisability of taking adequate reserves was never questioned, but any reserves should be taken after the profits have been taxed, not before.¹⁵

In 1926 there developed the practice of shareholders, particularly in closely held companies, taking loans from the company, living on the loans, and never repaying them. Why declare a dividend and pay tax? Loans to shareholders were made taxable as if they were dividends. Thereafter, actual dividends to the extent of the loans were not subject to tax. We really imposed the tax in the year the money was paid and used.¹⁶

Next, a practice of redeeming shares at a premium grew up—the premium, it was argued, was capital. The 1926 amendment provided that the premiums would be taxable to the extent of corporate earned surplus on hand and that

¹⁴14-15 Geo. V, c. 46, s. 5; R.S.C., s. 19.

¹⁵14-15 Geo. V, c. 46, s. 4(d); R.S.C., s. 6(d).

¹⁶16-17 Geo. V, c. 10, s. 8; R.S.C., s. 18.

stopped that.¹⁷ The next move was to redeem common stock of a highly capitalized company and live on the annual redemptions, leaving the earned surplus to be inherited by the next generation as an equity through the devolution of the remaining shares. Many heirs would pay less tax than the decedent would have paid on his dividends, because progressive tax rates on one person are, on a stated sum, more onerous than the same progressive tax rates among the many.¹⁸ The amendment made common stock redemptions taxable to the extent of earned surplus on hand.

Preliminary to the next point, may I say that dividends from one company that has borne income tax are not again taxable against the recipient shareholding corporation. That is, corporation rate of tax is not paid twice.¹⁹ The following was a particularly extensive scheme to reduce income and avoid tax. It is a little difficult to explain shortly, but I will try. There is a company with a large undistributed surplus. The individual shareholders want to get it out, tax free. A straight dividend or any of the methods described above would make it taxable in the hands of the individual shareholders. But why not have the individual shareholders sell their shares to a friendly trading company that is in the business of buying and selling shares—when it is known that the profit on the sale of shares by an individual is not taxable? Such a trading company will pay for the shares an amount over par equal to the earned surplus of the company. The trading company incorporates a new company of the same name as the old one with the surplus. This new company will sell its shares to the old company for its capital working assets only, not its surplus or accumulated earnings; thereafter, the old company has in its coffers or portfolio: (1) the shares of the new company, and (2) the accumulated earnings, no doubt invested in good government bonds. Then the old company winds up and distributes its assets to the trading company, which as a corporation, receives them tax free. The trading company then pays the original shareholder for his shares, with the same assets, *i.e.*, the shares of the new company, and the accumulated surplus. All this the trad-

¹⁷16-17 Geo. V, c. 10, s. 8(10); R.S.C., s. 17.

¹⁸16-17 Geo. V, s. 8(9); R.S.C., s. 16.

¹⁹7-8 Geo. V, 1917, c. 28, s. 3(b); R.S.C., s. 4(n).

ing company does for a very minor fee or profit. Thus millions of dollars of earned surplus which should have borne a tax on normal distribution were put into the hands of the original shareholder free of tax, on the basis of the sale of his shares for a capital profit. This means of avoiding tax was stopped by declaring that not only on the winding up shall the distribution of the property be deemed to be a dividend to the extent of the earned surplus, but that where such deemed-to-be dividend is received by another company it shall be income of that company and taxable against it, while if the company receiving the earned surplus is outside of Canada, the company which is being wound up must deduct and pay the tax on the deemed-to-be dividend at corporate rates. This put an end to that form of avoidance.²⁰

Another form of avoidance was for the shareholder to incorporate a small company and sell to it his shares of the operating company at a price which included the share capital of the new company and cash equal to the surplus in the operating company. The small company would borrow the money for a day from the bank and pay for the vendor's shares; thus the individual got his money as capital. Then the operating company would declare a dividend and the small company would use it to pay off the bank. The small company would then be wound up and the vendor shareholder would receive back his original share. Why declare dividends directly to the individual shareholder and pay tax? This was stopped by declaring that where a person transfers shares in a corporation to a corporation acting as his agent, trustee, attorney, or promoted at his instance, or directly or indirectly controlled by him, which second-mentioned corporation receives a dividend from the first and applies it either in payment of shares purchased, or in discharge of any loan obtained for such purpose, then such shareholder shall be taxed as if he had directly received the dividend.²¹

By reason of the amendments referred to and other amendments, it can be stated generally that, neither directly nor indirectly, can the earned surplus of a company be put out of the channel of taxation under any name or scheme, on distribution. It will be taxed, whether done by

²⁰20-21 Geo. V, c. 24, s. 4.

²¹16-17 Geo. V, c. 10, s. 8(11); R.S.C., s. 14.

way of ordinary dividend, winding up, stock dividend, premium, loan, or through controlled or personal corporations.

This brings us to personal corporations. The personal corporation sections were enacted and made applicable to the 1925 taxation period and were found completely satisfactory to carry out its intended purpose.²² What is a personal corporation? The definition²³ in the Act is very wide and includes any corporation controlled directly or indirectly by an individual resident in Canada, no matter when or where the company was created, or where it carries on business, whether within or without Canada, or where the situs of its assets may be. Indirect control is envisaged: (1) through members of the individual's family, through trusts or other controlled corporations, or any combination of them, holding the shares or any class of them; and (2) through the substance or assets of the company being under mortgage or bonds held by one such individual or indirectly in the same manner described. If the control is found by the minister to exist in such indirect way, then notwithstanding that the majority of the voting shares may be in other hands, the company is a personal corporation, provided further that one-quarter of the gross revenue is derived from the trading in stocks and bonds or from the lending of money or by way of rent, annuity, royalty, interest, or dividends. The income of such a corporation is deemed to be distributed annually and taxed against the shareholders, not necessarily in proportion to their share but on the value of the property transferred to the corporation. The minister has the power to determine the value of property so transferred.

Successive companies are dealt with as if they were the original or first company receiving the assets transferred. The shareholder must file the personal corporation return on penalty of double assessment at graduated rates on the full amount of the corporate income. Canada has not suffered any loss of revenue since this law was passed by reason of well-to-do residents of Canada transferring their assets to personal corporations. Every person that has a personal corporation is not a scoundrel. I believe in the advisability of personal corporations for Succession Duty purposes, not to avoid but to simplify Succession Duty.

²²16-17 Geo. V, c. 10, s. 3; R.S.C., s. 21.

²³R.S.C., s. 2(1).

Personal corporations do not minimize income taxes under the Canadian law.

Another method of reducing taxes is to have carrying charges assumed by companies in respect of matters not essential to their business. The law provides that charges or expenses of unproductive assets not acquired for the purpose of a trade, business, or calling, or a liability not incurred in connection with the trade or business, shall not be allowed as a deduction.²⁴

The husband or the wife cannot be partners for Income Tax purposes, neither can the one work for the other on a salary or remuneration basis. The income is all taxed against the one or the other. Further, in respect of transfers of property to the wife, or *vice versa*, the income therefrom is added to the income of the transferor and there taxed.²⁵ Then again in respect of trusts that are revocable or controlled by the donor, the income is taxed against the donor. If complete and irrevocable trusts are set up for children, then the income of all such trusts is taxed as one trust and at individual graduated rates.²⁶ The rate of interest payable on any loan as an allowable deduction is under the control of the minister, but no interest charge will be permitted to reduce income unless the money borrowed is used in the business to earn the income.²⁷

Attention has been drawn to all these avoidance methods and remedial measures, taken because they seem interesting and more so by reason of Mr. Roosevelt's recent message to Congress. All the loopholes he then referred to were blocked some years ago under the terms and amended terms of our law.

Amendments to Income Tax Laws

From the foregoing, it will be appreciated why there are so many amendments to Income Tax laws. There is some complaint of the annual, successive amendments. The business world seeks for stability in tax matters but keeps its affairs in a constant state of shift to avoid payment under the very laws in respect of which it calls for stability. So long as it is accounted a clever thing so to arrange your

²⁴16-17 Geo. V, c. 10, s. 3(11); R.S.C., s. 6(e).

²⁵R.S.C., s. 31.

²⁶I Edw. VIII, c. 38, s. 10.

²⁷13-14 Geo. V, c. 52, s. 2; R.S.C., s. 5(b).

affairs that being clearly within the letter of the law, they are shifted beyond the letter of the law, just so long will there be need for amendment.

The judiciary, in precise pronouncement, have in a broad sense influenced adversely the moral tendency of the public in their approach to, and consideration of, tax contributions on any ability-to-pay basis by stating that one may "avoid tax but must not evade it."²⁸ In effect this gives judicial approval of the constant shift of the affairs of taxpayers to avoid tax which the law intended to make them pay and, but for the shift, required them to pay. The shift in itself may have no business advantage to the taxpayer, indeed is often detrimental to his business, in which case the business suffers and the state suffers, while the taxpayer may effect some temporary tax advantage. Such approval is emphasized in the statement: "The motive or desire to reduce or escape tax is almost universal and is entirely legitimate. The test is not the motive, but the test is whether the contract in law is real and valid."²⁹ The legal sanctity of these moral evasions apparently has been brushed aside by the recent British budget. I understand that such transactions, though real and valid in law, nevertheless if entered into for the purpose of avoiding tax, are rendered ineffective by the amendment proposed. Such proposals are made by no less a lawyer than Sir John Simon. It is significant.

The text and incidence of the English law of 1842 have been amended over sixty times. Since the United States constitutional amendment of 1913, there have been enacted a dozen or more wholly new Revenue Acts taxing income, profits, and capital gains in the United States. The original measure of some twenty pages has been expanded to pages numbering in the hundreds. There are now over 115 jurisdictions imposing personal or corporate income tax laws, or both.

In 1914, in England the highest rate of income tax was 8 per cent., including both normal and surtaxes. A number of these new laws have rates as high as 60 per cent. All such laws have combined to create a serious situation pertaining to double taxation, not only internationally but as well between the lesser jurisdictions within the nation. The

²⁸*United States v. Isham*, 84 U.S. 496 (21 L.Ed. 728).

²⁹*Wiggin v. Commissioner*, 46 F. (2d) 743.

lesser jurisdictions within Canada and the United States are examples of this. Indeed, with the shipping industry entirely relieved from double taxation and over 140 bilateral agreements for the avoidance of international double taxation, it is perhaps true that there exists more double taxation within a nation than there exists between nations. The world is now decidedly Income Tax conscious—a common phrase but expressive. So conscious in fact that some cynic states that it is a neat question to determine whether more ingenuity is exercised in devising or in avoiding taxation.

Taxation at the Source

It is now accepted that the initial right to impose tax is at the source. The jurisdiction of residence must give some allowance for the tax paid at the source. This means that what formerly went into the Treasury of the jurisdiction of residence now goes into the jurisdiction of source. The greater the tax at the source, the greater the pressure for relief at the jurisdiction of residence. Now that the tax at the source is not on the net income but is on dividends and interest, without allowing for carrying charges, it raises doubt as to how long the relief from double taxation can be carried on, on the present basis. Then there might develop further complications by the jurisdiction of source giving a rebate of tax if the income is re-invested at the source. The jurisdiction of source would say that that was an invitation to invest and re-invest the yield of capital there, but, also in the result it affords an opening to refrain from advising the jurisdiction in which the taxpayer resides of the accumulating wealth abroad.

This raises the question of exchange of information and possibly mutual assistance in the collection of revenue, particularly if laws of an international character are used as a basis of fiscal fraud. Widespread and increasing Income Tax laws are internationally perhaps at that stage where tariff laws were when they were introduced for revenue purposes. The development of minimum, maximum, and intermediate tariffs and other special considerations might find a counterpart in the future development of Income Tax laws.

Income Tax laws have become as between nations a fiscal instrument of some force and in the future will become even more so, which brings one to the thought that an In-

come Tax should find its place as a senior measure in the national fiscal structure and not in the lesser jurisdictions within a nation which do not possess and cannot find international recognition. Income Tax laws are perhaps in the initial and interlocutory stage in world affairs.

SALMON CANNING AND BRANCH ACCOUNTING PRINCIPLES AS APPLIED TO SALMON CANNERY ACCOUNTS

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FORTUNATELY the genus "Oncorhynchus" is very prolific, otherwise the salmon industry would not have survived to become such a vital factor in the economic life of the countries bordering upon the North Pacific Ocean, as well as an extremely important contributor to the world's supply of foodstuffs. "Oncorhynchus" is the biological family name for the Pacific salmon which, until 1864 when it first appeared on the market in cans, was little known or appreciated as a fresh sea-food except by coast natives and a few English and American traders. Salt salmon in barrels had attained a fairly wide distribution prior to that year, but it was the introduction of the canning process which was responsible for the development and present place of canned salmon as one of the foremost contenders for supremacy in world markets of fishery products.

The five major species of the Pacific salmon family in the order of their value for canning purposes are as follows:—

	Average Weight (in pounds)
Sockeye	5½
Cohoe	8
Pinks	3½
Chums	9
Springs	22

In certain districts a species of the salmon or trout family, known as the steelhead, is also packed in sufficient quantities to warrant mention. In general, however, the number of cases of steelheads canned represents a very small percentage of the total pack.

Little is known of the life and habits of the Pacific salmon once they have attained an age, varying according to the species, of from a few months to two years and have left their native streams to spend the major portion of their lives in the ocean. When maturity is attained, the salmon prepares to leave the sea for the spawning grounds. One of the inexplicable phenomena of nature is the ability of these fish to return, after their wanderings, to the scene of their birth, where they spawn and then die. In many instances, this last migration may cover many hundreds of miles and their habit of assembling close to shore before commencing the final upstream stage of their journey provides the opportunity for catching them in quantities.

Salmon do not feed after leaving the ocean and in consequence must depend upon stored reserves of oil and fat for sustenance during the remainder of their journey. Frequently this takes them to the headwaters or higher tributaries of some of the larger Pacific rivers and streams. The oil content and other forms of stored energy reserves appear to bear a relationship to the distance to be travelled to spawning grounds.,

This habit of assembling or "schooling" creates what is known in the salmon fishing industry as a "run." These runs take place almost entirely in the months from May to November inclusive, and principally in July and August at which time the canning season attains its peak. The tendency of certain species to appear most abundantly at intervals of from two to four or five years, has resulted in what is termed "cycle" years. The pack in non-cycle years is comparatively small.

The sockeye, pink and chum seasons are the periods during which the bulk of the year's catch is packed. In each of these seasons, the fish of the species named predominate, although small numbers of other species may also be taken.

The runs of the various species, in the areas or districts into which the British Columbia coast has been divided, take place mainly in the following months:—

<i>Species</i>	<i>District</i>	<i>Months</i>
Sockeye	West Coast of Vancouver Island	May-June
	Northern Area	June to early August
	Fraser River	July to early September
Cohoe	All coast districts (by troll)	June
	All coast districts (by seine and gillnet)	August, September and October
Pinks	All coast districts	Late July and August
Chums	All coast districts	Late August to November
Springs	Northern Districts	January to May
	West Coast of Vancouver Island	(by troll) also August and September

Methods of Catching

Various methods are employed in catching salmon. Springs and Cohoes are the only varieties taken by trolling with hook and line. The fishing boats used for this purpose average from 30 to 50 feet length, and are fitted with four to ten long poles to which lines and spoon hooks are attached. All other species making up the great majority of the pack are caught in nets. A brief description of the various types of nets used follows:—

Gillnet—This consists of linen webbing, different sized meshes being used depending on the variety of fish sought. Corks or floats are attached at intervals along the top edge and the bottom edge weighted with a lead line. Fish large enough to be caught in the meshes of this net are unable to pass through and cannot withdraw when their gills become entangled. Because of its comparatively low price, and the lesser cost of the small power boat or sailing skiff used in conjunction therewith, the gillnet is the most widely used type of gear. Gillnets average 1200 feet in length and approximately 25 feet in depth.

Purse Seines—These nets vary from 900 to 1,500 feet in length and from 25 to 80 feet in depth. Because of their size and weight they require larger boats and equipment for handling. Seine boats range from 50 to 75 feet in length

and are fitted with a turntable and boom. When a school of salmon is detected a skiff, to which one end of the net is attached, is released and a circle then described around the fish by the seine boat. Both ends of the purse line or rope, which runs through large rings attached to the bottom of the net, are then drawn in to form the "purse," from which the fish are removed by a large brail or dipnet.

Dragnet or Beach Seine—This type of net is not largely used but is adaptable where conditions favour its use. The principle is somewhat similar to the purse seine except that it has no purse rings and is usually fastened by one end to the beach. A semicircle is then described around the salmon after which they are drawn up onto the beach.

Pound Net or Trap—This type of net is largely used in Alaska, being prohibited in Canada, except in one area. Wire netting or fabric is hung vertically to form a maze into which the fish pass but are unable to escape. The construction of the floating type is similar to the standing type except that the netting of the latter type is attached to poles driven into the bottom of shallower waters where fish are known to run.

Packing

Salmon canning has developed to such an extent that, except for certain grades of fancy salmon which are usually hand filled, the bulk of the catch is almost entirely packed by machine. After being sorted to species, conveyors carry the fish from the scows or fish packing boats to bins, from which they are drawn into flumes and carried to the "iron chink." This machine removes the head, tail, fins and viscera, at the same time cleaning and splitting the fish. They then pass over a table where washing and inspection takes place, before being delivered to the cutting and filling machines. These may be separate units or a combination cutter and filler in which the dressed fish is cut to size and placed in the can along with a measured quantity of salt. In larger plants automatic weighing machines are usually installed at this point over which each can passes, any slack or underfilled cans being diverted. Properly filled cans continue on to the clincher where the can top is lightly affixed. Thereafter they pass through a washer into the vacuum closer where the air is automatically extracted and in which rolls complete the clinching and

sealing of the cans. After another cleaning in a hot chemical solution the cans are placed in trays or "coolers" and loaded on to narrow gauge railway trucks, which are then pushed into large steam retorts. Here the first and final cooking takes place. After one last washing the cans are ready for labelling and boxing. Canned salmon is subject to rigid government inspection before sales can be made either in domestic or foreign markets.

Corporate Organization

Because of the large initial expenditures for cannery sites, wharves, fishing and floating equipment, bunk houses, store and cannery buildings and equipment, etc. success in the salmon canning industry favours the corporate form of organization, with its greater facilities for obtaining adequate financing.

Besides the investment in plant and equipment, considerable sums must be expended annually at each cannery in preparation for the ensuing season, without any assurance of favourable results. For this reason it is advantageous to have a number of canneries situated at strategic points, so that operations may be curtailed at plants where results are not favourable, and efforts concentrated at other points where heavier runs are taking place. Such a policy requires that the management be in possession of up-to-the-minute information concerning all phases of operations at each cannery. This entails the maintenance at head office of duplicates of each of the cannery ledgers or alternatively a system providing such control and detailed accounts as are required for the preparation of individual cannery operating statements, combined operating figures and monthly balance sheets of the company as a whole.

Accounting System

Excellent articles have been contributed in the past covering various aspects of salmon industry accounting, to which any further contribution would seem to be possible only at the expense of undue repetition. It is, therefore, not the intention to repeat what has previously been so ably treated, but rather to outline the mechanics of a system which appears to be capable of application in other lines of business. This system retains most of the advantages of duplicate records without the attendant disadvantage of excessive cost.

The principles of the conventional branch accounting system are employed, inter-office accounts being maintained between each cannery and head office. The following records are kept at the canneries:

- Synoptic report
- General ledger
- Personal or fishermen's ledger
- Fish Ledger—
 - Book fish
 - Cash fish
- Payroll book
- Coupon register (Commissary purchases)

Excepting the synoptic report which is fully dealt with subsequently, the personal or fishermen's ledger and the fish ledger are the only records differing in form and function from records of a similar name, usually encountered in other businesses.

Personal or Fishermen's Ledger—All personal accounts including those with fishermen are maintained in this ledger. Debits consisting of charges for cash advances, coupons, nets and supplies are posted thereto. Credits for wages, etc., are posted periodically from payrolls to the accounts of cannery crew employees. At the end of the season book fish fishermen's accounts are credited by journal voucher with the total of their earnings for fish delivered to the cannery, obtained from the fish ledger. A settlement of balances due is then effected.

Fish Ledger: Book Fish—Fish pass books are issued to each fisherman at the commencement of the season, in which all fish delivered to the cannery collecting boats or wharf tallymen are entered and initialled for. Periodically (usually weekly) these pass books are turned in to the cannery office to see that they are in agreement with the fishermen's fish ledger account, which has been written up daily from boat tally sheets. The ledger sheet is in columnar form and shows, by species, the quantity and value of each day's deliveries. During the season no entries are made in the cannery books to record the liability for book fish.

Fish Ledger: Cash Fish—The ledger sheet is the same as for book fish. Quantities and amounts of individual cash purchases or totals of cash fish book sheets, hereafter

described, are entered under the appropriate species heading, the grand totals of which agree with the cash items in raw fish account in the general ledger.

Synoptic Report—This form is prepared in duplicate and is in effect a control sheet on which all cannery transactions are recorded in detail or in summary form from original sources as follows:

Cash received voucher
Cash paid voucher
Cannery draft
Journal voucher

It consists of a columnar journal sheet drawn up under the following headings:—

Assets and liabilities control	Dr. and Cr.
Operating ledger	Dr. and Cr.
Date	
Journal or cash voucher number	
Particulars	
Folio	
Personal ledger	Dr. and Cr.
Cash	Dr. and Cr.
Drafts issued	Cr.
Draft number	
Head office	Dr. and Cr.

Cash transactions are entered thereon in detail, from serially numbered cash received or paid vouchers or from cannery draft stubs. Where the volume of cash fish purchases is large, a columnar cash fish book is used on which quantities and amounts are analyzed by species of fish corresponding to the fish ledger sheet columns. When detached, the original sheet together with accompanying cash paid vouchers forms a summary of cash fish purchases for a given period, in support of the total entered on the synoptic report.

All other transactions are recorded by journal voucher giving necessary descriptive narrative, or supported by original sheets abstracted from various subsidiary records, also prepared in duplicate, e.g. payroll book, stores sales and issues summaries, etc.

Postings are made from the synoptic report or journal vouchers direct to the cannery general or personal ledgers.

A large proportion of head office entries affecting canneries consists of charges for operating materials and supplies, etc. A separate invoice account is kept in head office books for each cannery. An invoice statement form is provided, the left hand side of which is in ledger form. The use of mechanical bookkeeping equipment permits the preparation of this statement at the same time as ledger postings are made to the cannery invoice account. The right hand side of the invoice statement is in columnar form on which the distribution of each invoice is entered at the cannery, after routine approvals as to receipt of goods and the account to be charged have been obtained from the stores man or cannery foremen. A journal voucher is then prepared by the cannery bookkeeper giving effect to the distribution. All charges must be accepted by the cannery, any excess or improper items being adjusted by journal voucher originating at the cannery, copies of which are forwarded to head office as well as to any other cannery affected. This procedure simplifies reconciliation of inter-account balances between head office and canneries, by eliminating differences due to individual invoices in transit not being taken up.

A monthly trial balance is abstracted and forwarded to head office on a standardized working sheet form, on which columns are provided for cannery balances (Dr. and Cr.) head office adjustments (Dr. and Cr.) and adjusted balances (Dr. and Cr.) This trial balance is divided into sections in which the individual accounts are listed in ledger order under the following headings and sub-headings:

Assets and Liabilities

Sundry inventory accounts, etc.

Operating

Fishing and collecting costs

Unit costs

Plant costs

District costs

Sundry costs

The totals of these sections are carried to a final balanced summary of all ledger balances consisting of:—

Assets and liabilities control

Operating control

Personal ledger control

Cash

Drafts issued

Head office account

The balances shown opposite these headings must agree with the cumulative column totals of the last synoptic report.

Based upon data obtained from perpetual salmon inventory records, and information furnished through the medium of daily reports of salmon packed and weekly fish received reports, forwarded as often as the mail will allow, entries are prepared at head office to record the estimated liability for fish purchases, contract packing labour, reserve for freight from canneries, etc. These items are not recorded on the head office books, but are entered during the season on the cannery trial balance in the head office adjustments column, for interim statement purposes only. The adjusted balances are then summarized on columnar forms under various asset, liability and operating account headings, for use in the preparation of the combined balance sheet and operating statement of the company. Inter-office accounts between head office and canneries are eliminated on consolidation. At the year end detailed analysis schedules of the cannery operating and supplies inventory accounts are prepared for submission to the management, which affords a complete record of all expenditures on canning operations at each plant.

* * *

It has not been the intention to describe special phases or problems of the fish canning industry, such as the difficulties of attempting periodically to determine the profit or loss on a seasonal operation, the various methods of apportioning costs to each species and grade of fish, the manner in which budgetary control may be applied, or any one of the many problems encountered by the cannery operator.

Each of the foregoing would provide adequate subject matter for a paper in itself. However, since the system here described permits the incorporation of almost any desirable feature of modern executive control in a business where production centres are often remotely situated, it was felt that a general description of the methods used might prove of interest.

INCOME WAR TAX ACT DECISIONS

1. The Snyder and Applegate Cases

The appellants in these cases, Clarence E. Snyder and William Applegate, were each assessed for additional income tax and as the source of the alleged additional income was the same the cases were heard together and one judgment was written by Mr. Justice Maclean of the Exchequer Court of Canada on 27th August 1938.

Oil Lease

The appellants and associates in 1933 acquired a license to drill for oil on certain Alberta lands. The consideration or rental took the form of an obligation to drill one well and to operate the same and dispose of any petroleum products and gas if recovered therefrom in commercial quantities. A further consideration was an obligation to pay a percentage of the value at the well of the yield therefrom. As the company from which the appellants acquired the lease was itself a lessee, the appellants had to accept the burdens under the head lease and agree to pay a further percentage of the value of the production to the head landlord. In the result 25% of the eventual production was ear-marked for the landlords.

Assignment

The appellants and their associates on the same day as they acquired the license or lease assigned it to a company controlled by them, Sterling Royalties Limited, which assumed the obligations of the appellants under the license. Shares in the capital stock of the company were allotted to the assignors as part consideration. The company obligated itself to sell, not its shares, but percentages or units of production as they were termed in order to finance the drilling of the well. These units were the same as those to which the landlords were entitled. Any units of production remaining were to be divided by the company amongst the appellants and their associates. It was an important factor in the decision that the remaining units so to be divided were to bear certain charges agreed upon by the assignors and including a sum of \$15,000, part of the price to be paid to one Hilary H. Head to drill the well. An agreement was subsequently entered into between Head and the Company for the drilling of the well for \$30,000, half payable in cash in monthly instalments and the bal-

ance out of "the sale of production at the rate of \$2,000 per month but not to exceed 40% of the net production coming to the owner after the payment of all royalties in connection with the said wells." The quoted words are taken from the agreement. Head was also entitled to a bonus of \$2,500, also payable from production if he was successful in placing eight-inch casing at a depth of 5,000 feet. The final preliminary agreement was between the company and a trust company as trustee for holders of units of production.

Oil

The well was brought into production by February, 1934, and the appellants and the company entered into another agreement. Enough units had been sold to pay Head his first \$15,000. The agreement provided for the pooling of the interests of the individuals in the unsold units of production in order to pay "all costs, charges and expenses agreed to be paid by them" amounting to \$20,000 and including the \$15,000 still due to Head. Such charges were to be paid out of the amounts paid to the trustee and which otherwise would have been payable by the trustee to the appellants. In due course Head was paid by the trustee and the Department of National Revenue contended that the amount paid to him was income in the hands of the appellants in the proportions in which they were entitled as owners of units of production.

Judgment

The assessments were confirmed and the appeals were dismissed. Mr. Justice Maclean felt that the appellants having agreed originally that the units to which they would ultimately be entitled should be charged with the costs and charges in question, the situation was the same as if the proceeds received by them had been applied in payment of the costs and charges. Head could only be paid out of such remaining units of production or the proceeds of sale thereof. Failure to sell the units had increased the equity of the appellants. The payment to Head released the appellants of the obligation represented by the charge or encumbrance recorded against their holdings of units of production in the books of the trustee. The source of the payment was income to the appellants and the disbursement was not one for which any deduction might be claimed.

2. The W. R. Wilson Case

This was an appeal by the Executors of the estate of W. R. Wilson from a decision of the Minister affirming an assessment levied against Mr. Wilson during his lifetime for the 1932 taxation period. Judgment was rendered by Mr. Justice Maclean on 8th September 1938. The appeal involved three quite separate and unrelated items, all of which will be found to be of interest.

Personal Corporation

Mr. Wilson controlled a personal corporation within the meaning of the Act and was accordingly assessable for the income of the corporation, Wilson Mining & Investment Company Limited, whether actually distributed or not, such income being deemed by the Act to be distributed in each year as a dividend to the shareholders. The corporation was incorporated, *inter alia*, to acquire the interest of Mr. Wilson and of the members of his family and others in mines, mining lands, mining companies and mining ventures and investments, and also to carry on the business of a mining and investment company in all its branches, to acquire by purchase, lease, hire, discovery, location or otherwise, and to hold, work and develop mines, mineral claims, mineral leases, mining lands, prospects, licenses and mining rights of every description, and to render the products thereof merchantable, and to buy, sell and deal in the same or any product thereof. There was also a general power to acquire, hold, sell and dispose of securities or investments.

Deductible Expenses

The Corporation's income during the taxation period arose entirely from the investments except for a small amount of interest on moneys on deposit. A deduction was claimed from its income of approximately \$20,000, mainly arising in connection with location, survey, exploration, prospecting and assessment work carried out on mining claims or properties. This deduction was disallowed by the Minister on the ground that they were disbursements or expense not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income as provided by section 6(a) of the Act. The learned Judge upheld the Minister in his disallowance of these items, stating that no revenue was expected to be earned by reason of

the expenditures in question in the 1932 taxation period and that they were in the nature of capital expenditures and not related in any way to the earning of the income of the Wilson Company. If the mining properties upon which the expenditures were made were later sold, the Judge thought the proceeds would be treated as a return of capital.

Consolidated Return

The corporation wished to file a return in which its profit and loss account was consolidated with that of Pleasant Valley Mining Company which was a subsidiary. Section 35(3) of the Act provides, however, that the right to consolidate a profit and loss account with the profit and loss account of a subsidiary is dependent on the subsidiary carrying on the same class of business as the parent company. As to this Mr. Justice Maclean felt that the two companies were not engaged in the same class of business and ruled against the appellant. The subsidiary carried on the business of mining coal and nothing else. The Wilson Company did not engage in this class of business though it owned or controlled a coal area called the "Blue Flame," which was the area upon which it had expended the \$20,000 disallowed as a deduction. Evidence was placed before His Lordship to the effect that the property had never been a "coal mine." The words in the Statute "carry on the same class of business" meant that before a consolidated statement might be filed the business of each company must be of the same class so that in the practical sense their business operations might be regarded as one business concern. He thought the words "carry on the same class of business" should be narrowly construed and he held accordingly that the two companies were not carrying on the same class of business and that the consolidation of the profit and loss accounts could not be permitted. The learned Judge thought it was arguable that the word "company" in section 35(3) was not intended to apply to a personal corporation and that some difficulty might be encountered in applying the section to a personal corporation. He did not, however, pronounce any definite opinion on the point.

Premium on Dividend Cheque

The remaining point in the appeal concerned an item of \$5,675.76, being premiums received on dividends paid by

Premier Gold Mining Company to the Wilson Company in United States funds. The point in issue was whether the appellant in respect of such premium income was entitled to an exemption or deduction for exhaustion authorized in the case of income derived from mining by section 5(a) of the Act. The right to the allowance was not disputed with respect to the face value of the dividend cheques received but the Minister disallowed the claim with respect to the premium upon the face value of the cheques when converted from United States currency into Canadian currency. The claim of the appellant in this respect was allowed. Notwithstanding that the Wilson Company was not a dealer in exchange, the question was whether the premium constituted "income derived from mining" being the words used in section 5(a). The Minister contended that the cashing of a dividend cheque was a monetary transaction in respect of which depreciation or depletion did not enter but His Lordship thought that as the source of the premium income was dividend cheques issued to a shareholder by a mining company, the net proceeds of the dividend cheques would be the dividend income received. If United States funds in terms of Canadian currency had been at a discount, the Wilson Company would not have been taxed on the amount of the discount but only on the net amount received. He thought there was no authority for separating the premium from the face amount of the cheque. His Lordship made no pronouncement as to costs but reserved the question until settlement of the minutes of judgment.

**INTERNATIONAL RAILWAY COMPANY v. THE
NIAGARA PARKS COMMISSION**

An Accountant's Point of View

George P. Keeping, Chartered Accountant, Montreal

PURSUANT to an agreement dated 4th December 1891, the International Railway Company, operating an electric railway along the Canadian bank of the Niagara River, notified the Parks Commission that it did not desire a renewal of its franchise which expired on 1st September 1932. The railway, equipment and works thereupon became vested in the Parks Commission and the company was entitled to be "duly compensated by the Commissioners for their railways, equipment, machinery and other works. . . . but not in respect of any franchises for holding or operating the same, such compensation to be fixed by mutual agreement, or in case of difference, by arbitration." Arbitrators were duly appointed, and a majority of them fixed the compensation at \$179,104.00. This award was based on the estimated value that could be realized from the disposal of the component parts of the railway as at 31st August 1932, in other words "scrap value." The dissentient arbitrator, however, was of the opinion that compensation should be based on cost of reconstruction less depreciation, and it was agreed that on that basis compensation would amount to \$967,592.00. The Court of Appeal for Ontario unanimously upheld the opinion of the majority arbitrators. The Judicial Committee of the Privy Council held, however, that the compensation should be calculated on the basis of reconstruction cost less depreciation, which, in the words of the arbitrators, was arrived at after making "proper allowance for the age and obsolete type of the machinery and equipment."

Briefly, the majority arbitrators took the stand that, as the railway had been consistently operated at a loss and as there was no prospect of any change in this condition, it was of value to the Commission only as scrap. The Privy Council on the other hand held that the company, on the expiry of the franchise, was obligated to hand over the undertaking as a going concern and not as a mere collection of materials, and that the consideration of past or future profits or losses was not relevant.

The wide spread between the two valuations submitted seems to the writer to make the case of interest to the accountant. At first sight this spread may appear to have little significance. The accountant is fully aware that scrap values or estimated realizable values of fixed assets normally find no place in a balance sheet and that a balance sheet drawn up on a forced sale basis would show a picture very different from that shown by the usual historical document. Similarly, one would expect a valuation of the assets of a "healthy" going concern on the basis of reconstruction cost less depreciation to be considerably in excess of a valuation made on the basis of scrap values.

Was the International Railway Company, however, a "healthy" going concern? In that it operated the railway, as it was bound to under the agreement, up to midnight on 31st August 1932, it might be considered as a going concern, but in no sense of the word could it be termed "healthy." For the last thirteen years of operation substantial losses, after providing for bond interest, had been sustained, and, due to the steady increase in popularity of the automobile, there was virtually no prospect of profits being earned in the future. It is submitted that in the case of this undertaking a valuation on the basis of reconstruction cost less depreciation should arrive at a result closely approximating, if not the same as, a "scrap valuation."

It is now generally accepted that one of the factors contributing to depreciation of fixed assets is obsolescence. Chief Justice Hughes in the case of *Lindheimer v. Illinois Bell Telephone Company* recognized this fact in the following words: "Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence." Loss due to physical depreciation can be dependably estimated by experts who take into account the physical condition of the property and its age in relation to its expected service life. There is no such observable characteristic of obsolescence. Among the numerous factors causing obsolescence are changes of fashion, invention and scientific discovery, and their effect on the value of a particular item of machinery may be either gradual or sudden rendering it worth only its salvage value almost overnight. It is obvious, therefore, that loss due to obsolescence is

extremely difficult to make provision for and that the best informed estimates often prove to be wholly inadequate. In the case of the particular undertaking under discussion, for instance, who could have foreseen at the time of building the railway that its useful life would be exhausted before the franchise terminated? If this fact could have been foreseen the railway never would have been built, because the annual provision for depreciation, mainly obsolescence, would have rendered the cost of service prohibitive. Though, in most cases, considerably more difficult to make provision for than physical depreciation, obsolescence results in a loss no less real; in fact when an item of property is retired it is not practicable, as a general rule, to identify the difference between the cost of the property and its salvage value as being so much obsolescence loss, so much wear and tear loss, etc.

What guide is there to the measurement of loss through obsolescence? Since there are no physical characteristics by which the loss can be measured it is necessary to consider the effect of the forces of obsolescence upon an undertaking. Obsolescence, like physical depreciation, makes itself felt by a reduction in earning capacity. It is submitted that loss due to obsolescence, unlike physical depreciation, can only be measured by reference to earning capacity and that, therefore, a consideration of earning capacity is essential in estimating loss in value due to depreciation in its broadest sense.

Returning to the case under discussion, it is apparent that the railway, as such, at 31st August 1932 had no earning capacity, whatever the capital structure of the company might have been, and that obsolescence had run its full course. If, then, no anterior agreement had existed and the value to be placed on the assets had been purely a matter of negotiation between an ordinary vendor and purchaser, the purchase price agreed upon would undoubtedly have been based upon scrap value. In other words, the loss represented by the difference between the cost of and the salvage value of the assets would have been treated as having been sustained prior to 31st August 1932 regardless of the extent to which that loss had already been incorporated in the accounts by way of depreciation provisions.

On reflection it seems that the existence of the agree-

ment can have little bearing on whether or not the loss was sustained prior to 31st August 1932, and that the agreement can be but a factor in determining whether and to what extent the loss should be borne by the Parks Commission. Their Lordships held that the company must be compensated on the basis of reconstruction cost less depreciation. Therefore, on the theory that the loss was sustained prior to 31st August 1932, it follows that the Parks Commission was called upon to bear the loss to the extent that the valuation on that basis exceeded the scrap valuation. That this view was not held by their Lordships is evidenced by the following excerpt from their judgment:

It is a familiar feature common to all cases in which a franchise for a public utility is granted to private undertakers for a limited period, coupled with an obligation to transfer the undertaking to a public authority at the conclusion of the period, that the undertakers must look to reap the reward of their enterprise in the profit which they may make during the currency of their franchise and on its expiry shall receive only the value of the structure which they have created without any compensation either for the profits or the losses which they may have made or sustained while in the enjoyment of their franchise.

Is it not clear, therefore, from the award made that their Lordships considered that "the value of the structure which they have created" was reflected by the valuation on the basis of reconstruction cost less depreciation rather than by the valuation on the basis of scrap value, and that they did not consider that the loss represented by the difference between the two valuations had already been sustained?

The accountant has learned to be extremely wary in his use and interpretation of the word "value." Nevertheless, he must surely find it difficult to understand how an undertaking in similar circumstances to the International Railway Company at 31st August 1932 could possibly have any value at all as a going concern. Is it not true that the maximum value of the assets of that company lay in their break-up value? In the opinion of the writer, if the depreciation taken into account in the valuation on the basis of reconstruction cost less depreciation had reflected the full loss incurred through obsolescence of the road and other assets, as well as the machinery and equipment, then the valuation on that basis would have shown a result identical to the scrap valuation. Should not the estimated ability of an undertaking, whether industrial or a public utility, to earn profits be a prerequisite of a valuation on the basis of reconstruction cost less depreciation?

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

OFFICERS AND COUNCIL

1938-39

Executive Committee

President	William E. Hodge, F.C.A., Moose Jaw, Saskatchewan
Vice-President	Arthur E. Cox, F.C.A., Saint John, New Brunswick
Past President	Frank A. Nightingale, C.A., Halifax, Nova Scotia
Chairman Finance Committee	Lieut.-Col. Albert E. Nash, F.C.A., Toronto, Ontario
Chairman Legislation Committee	Henry G. Norman, C.A., Montreal, Quebec
Additional Member Executive Committee	Frederick Johnson, C.A., Winnipeg, Manitoba
Secretary-Treasurer	Austin H. Carr, M.A., C.A., 10 Adelaide St. East, Toronto

Council

<i>Representative</i>	<i>Elected by:</i>
G. P. Ponton, C.A., Edmonton	} The Institute of Chartered Accountants of Alberta
F. A. Smith, C.A., Calgary	
J. Harvey, C.A., Vancouver	} The Institute of Chartered Accountants of British Columbia
E. C. Mapson, C.A., Vancouver	
W. G. Rowe, C.A., Vancouver	
W. Gray, C.A., Winnipeg	} The Institute of Chartered Accountants of Manitoba
F. Johnson, C.A., Winnipeg	
T. W. Saul, C.A., Winnipeg	
Arthur E. Cox, F.C.A., Saint John	} The New Brunswick Institute of Chartered Accountants
J. E. Lloyd, C.A., Halifax	} The Institute of Chartered Accountants of Nova Scotia
F. A. Nightingale, C.A., Halifax	
G. D. Campbell, F.C.A., Toronto	} The Institute of Chartered Accountants of Ontario
W. G. H. Jephcott, C.A., Toronto	
A. E. Nash, F.C.A., Toronto	
G. P. Nicholson, C.A., Charlottetown	} The Institute of Chartered Accountants of Prince Edward Island
A. Ballantyne, C.A., Montreal	} The Society of Chartered Accountants of the Province of Quebec
H. G. Norman, C.A., Montreal	
M. Samson, C.A., Quebec	
W. E. Hodge, F.C.A., Moose Jaw	} The Institute of Chartered Accountants of Saskatchewan
T. E. Robinson, C.A., Regina	
W. Stempel, C.A., Saskatoon	

Chairman Magazine Committee—William J. Saunders, F.C.A., Toronto
 Chairman Terminology Committee — John Parton, F.C.A., Winnipeg
 Chairman Committee on Education—Kris A. Mapp, F.C.A., Toronto

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The Dominion Association of Chartered Accountants

President



WILLIAM E. HODGE, F.C.A.
Moose Jaw, Saskatchewan

At the annual meeting held in Halifax, Nova Scotia, August 22nd to 25th, Mr. Hodge was elected President of The Dominion Association of Chartered Accountants for the year 1938-39.

Supplement to October 1938 issue—The Canadian Chartered Accountant



GENERAL NOTES

Matters of Interest to Members

Report of Annual Meeting

The thirty-sixth annual meeting of The Dominion Association of Chartered Accountants was held in the Nova Scotian Hotel, Halifax, Wednesday and Thursday, 24th and 25th August, and was attended by representatives of the profession in every Province of the Dominion. The executive committee met on Monday morning, the 22nd, and the council on Monday afternoon and all day Tuesday. Frank A. Nightingale, C.A., President of the Association, presided at the sessions. Following is the report of the attendance of Provincial Institutes:

Alberta	3
British Columbia	4
Manitoba	4
New Brunswick	6
Nova Scotia	36
Ontario	8
Prince Edward Island	1
Quebec	8
Saskatchewan	4
	<hr/>
	74
Representatives of other Societies	2
Ladies and visitors	57
	<hr/>
	133
	<hr/>

The Institute of Chartered Accountants in England and Wales was represented by George Cochrane, New York, who was the guest speaker at the luncheon on Thursday; the American Institute of Accountants by William C. Heaton, New York, who read a paper on the profession in the United States at the Thursday sessions; the Societies of Chartered Accountants of Scotland by Kenneth W. Dalglish of Montreal; and the Society of Incorporated Accountants and Auditors of Great Britain by Kris A. Mapp of Toronto. Cables and telegrams of greetings were received from Lord Plender and Sir Arthur Cutforth of London, and from three former Presidents—A. F. C. Ross of Montreal, John Parton

of Winnipeg (temporarily in England) and Alfred B. Shepard of Toronto.

At the opening session on Wednesday the members of the Association were welcomed to the Province of Nova Scotia by Hon. Angus L. Macdonald, Premier of the Province, and by Alderman John J. Power, K.C., Deputy Mayor of the City of Halifax. Gerald Hayman, Vice-President of the Nova Scotia Institute, welcomed the visitors on behalf of the profession of the Province.

In his reply to the addresses of welcome, George E. Winter of Vancouver, immediate Past President of the Association, expressed the thanks of the visitors for the kindly welcome just received and for the many courtesies already extended to the representatives of the other Institutes since their arrival in Halifax.

Proceedings of Meeting — At the opening session the President announced the sad news of the sudden passing at Calgary on 3rd August of Frank M. Harvey, a beloved past President of the Association, and paid tribute to the contribution which he had made to the progress of the profession in Canada. By a unanimous resolution of the annual meeting, the following resolution was passed:

WHEREAS the members of the Dominion Association of Chartered Accountants learned with deep regret of the death at Calgary on August 3rd last of one of their beloved Past Presidents, Mr. Frank Micklewright Harvey, F.C.A.;

AND WHEREAS Mr. Harvey has been a familiar figure at many of the annual meetings of the Association, was well known to a large number of the members of the Association, and had contributed extensively to the advancement of the profession generally throughout the Dominion;

THEREFORE BE IT RESOLVED that this Association enter upon its minutes an expression of its sense of deep loss through the passing of a distinguished fellow member and a true friend;

AND BE IT FURTHER RESOLVED that a copy of this resolution be sent, with an expression of the sincere sympathy of the members, to Mrs. Harvey and her daughter, Mrs. G. J. Weekes.

This year's meeting in Nova Scotia completed the circuit

of annual meetings in the several provinces since the establishment of the permanent secretariat of the Association in 1930 and the appointment of Austin H. Carr as Secretary-Treasurer and Editor of THE CANADIAN CHARTERED ACCOUNTANT. In his presidential address, Mr. Nightingale reviewed the growth and advancement of the profession during these years. He also took occasion to refer to the need of the members of the profession to give consideration to matters of national interest, and referred specially to the problem of unemployment and the importance of a well considered Canadian policy on immigration. His address is published in this month's issue.

Matters of importance to the profession were considered at this year's meeting, among them being a standardized programme of education for the chartered accountant student, uniform examinations, accounting research, and members' benevolent and annuity funds. A copy of the proceedings of the general sessions will be sent shortly to the Secretary of each Provincial Institute and a report of the meeting will be published in the 1938-39 Year Book of the Association which will be reaching members on or before 31st October. Included therein will also be the annual reports of the nine constituent Institutes of the Association and the reports of the several committees of the Association on finance, students' education, legislation, terminology and the Magazine of the profession.

Addresses—At the general session on Thursday morning William C. Heaton, New York, read a paper on "The Profession in the United States" and H. G. Norman, Montreal, one on "Our Profession—Quo Vadis?" both of which provoked interesting discussion. On Thursday afternoon there was a roundtable discussion, with Kenneth W. Dalglish of Montreal as chairman, on the subject "Should the Statutory Form of the Auditor's Report to the Shareholders be Changed?" The presentation of the subject in this way was a departure from the usual programme of annual meetings, and the interest in the subject and the participation in the discussion by nearly everyone present were an indication to the programme committee that roundtable discussions should form a part of future meetings.

Entertainment—Though the four days' session called for much business to be transacted, the social side was not neglected. The committee on arrangements of the Nova Scotia

Institute had for months made preparations for the entertainment of the visitors. The reception on Tuesday evening, the golf tournament and the sail on the famous schooner "Bluenose" on Wednesday afternoon, the supper dance the same evening, the luncheon at noon on Thursday, the afternoon drive for the ladies, and the banquet that evening—all were happy events long to be remembered. The Nova Scotia Institute, with Mr. Lloyd as chairman of the committee on arrangements, received the hearty thanks of all for the fine entertainment provided during these "days of glorious life" in historic Nova Scotia.

Hon. J. L. Ilsley, Minister of National Revenue, was the guest speaker at the banquet on Thursday evening and delivered an interesting and instructive address on the subject, "Public Service in a Democracy," which will be published in a coming issue of THE CANADIAN CHARTERED ACCOUNTANT.

During the banquet meeting, Kenneth W. Dalglish, C.A., on behalf of the members of the Association, expressed very great appreciation of the services to the Association of their much esteemed fellow-member—George E. Winter, Esq., F.C.A., who was President of the Association in 1921 and in 1937 and a member of the Executive Committee for the past three years. A leather covered volume of extracts taken from THE CANADIAN CHARTERED ACCOUNTANT and the Year Book published during his terms of office, with a suitable inscription therein, was presented as a memento to Mr. Winter.

Among the distinguished guests present at the banquet were: The Honourable Sir Joseph Chisholm, Chief Justice of Nova Scotia; The Honourable J. Lorimer Ilsley, Minister of National Revenue, and Mrs. Ilsley; Mr. Walter Mitchel, Mayor of Halifax, and Mrs. Mitchel; The Honourable John A. Walker, President, Nova Scotia Barristers' Society, and Mrs. Walker; Mr. George Cochrane, New York City; Mr. William C. Heaton, Vice-President of the American Institute of Accountants, New York City, and Mrs. Heaton; Mr. James Garrow, Supervisor, Bank of Montreal, and Mrs. Garrow; Mr. W. G. Kent, Inspector of Income Tax, and Mrs. Kent.

Officers—Following are the officers of the Association for the year 1938-39: President, William E. Hodge, F.C.A.,

Moose Jaw; Vice-President, Arthur E. Cox, F.C.A., Saint John, N.B.; Immediate Past President, Frank A. Nightingale, C.A., Halifax; Chairman of Finance Committee, Lieut.-Colonel A. E. Nash, F.C.A., Toronto; Chairman of Legislation Committee, H. G. Norman, C.A., Montreal; additional member of Executive Committee, Frederick Johnson, C.A., Winnipeg; Secretary-Treasurer, Austin H. Carr, C.A., Toronto.

Our Contributors This Month

Most of the contributors to this month's issue are familiar to our readers. FRANK A. NIGHTINGALE of Halifax was at the time of his address President of The Dominion Association of Chartered Accountants.

GEORGE COCHRANE is a native of England, lives in New York and is the senior partner in United States of Deloitte, Plender, Griffiths & Co. All who attended the fiftieth anniversary celebrations of the American Institute of Accountants a year ago in New York will remember him as the chairman on arrangements of that wonderfully successful convention.

C. FRASER ELLIOTT, K.C., Ottawa, is the efficient Commissioner of Dominion Income Tax.

GEORGE P. KEEPING was born in London, England, and was educated at Felsted School. He served his articles with Trayton P. Child & Son of London and, on being admitted as an Associate of the Institute of Chartered Accountants in England and Wales, joined the staff of the Paris office of Deloitte, Plender, Griffiths & Co. In 1932 he came to Canada and was employed in the Montreal office of the same firm and has been a partner of that office for the last three years.

L. R. SINCLAIR who writes on the subject of salmon fishery accounts this month was born in the United States. He moved to Calgary as a boy, received his high school education there, and during the War saw overseas service with the Air Force. He served his articles with Messrs. Riddell, Stead, Graham and Hutchison, Vancouver, and passed the final examinations of the Institute of Chartered Accountants of British Columbia in 1924. He is at present engaged with Price, Waterhouse & Company in Vancouver.

Licensing Trustees in Bankruptcy

The annual report for the year 1937 of the Superintendent of Bankruptcy for Canada (King's Printer, Ottawa) contains a brief review of the licensing of trustees since January 1933, when the licensing provisions of *The Bankruptcy Act Amendment Act, 1932*, came into force. According to the report, during the five years from that time to the close of 1937 a decrease of more than thirty per cent. in the number of licensed trustees has occurred. This decline is attributed chiefly to the voluntary withdrawal of licensees who found that the volume of bankruptcy work available was insufficient to warrant a renewal of their licences. A marked decrease in the number of new bankruptcies has accelerated the trend.

The report stresses the fact that the issuance of new licences should be governed by the public interest, limiting the number of trustees to a degree commensurate with the volume of work available, in order to avoid a recurrence of the abuses which the licensing system was designed to remove.

Fire Destruction Losses

A notice published in *The Canada Gazette*, Ottawa, 10th September 1938, proclaiming the week commencing Sunday, 9th October 1938, as "Fire Prevention Week" draws attention to the appalling loss of and injury to lives and property by fire during the past seventeen years. Reliable statistics compiled by the Dominion Fire Commissioner, and cited in the proclamation, show that during this period 727,000 fires in Canada have destroyed more than \$677,000,000 of insurable property; taken 7,200 lives and caused injury to 22,000 other persons. The proclamation urges the co-operation of all public bodies and private citizens during "Fire Prevention Week" in emphasizing the hazards of fires, and in taking the precautions which will tend to reduce this danger with its attendant irrevocable losses in life and property.

The 1938 Canada Year Book

We are advised by the office of the Dominion Bureau of Statistics of the Department of Trade and Commerce, Ottawa, that the 1938 volume of the Canada Year Book is now

available. This publication of the Federal Government consisting of almost 1200 pages is the official statistical annual of the country and contains information on the natural resources of the Dominion, the history of our country, together with the latest figures on its different branches of production, trade, transportation, finance, education, etc. A copy may be obtained from the King's Printer, Ottawa, at the price of \$1.50.

LEGAL DECISIONS

[EDITOR'S NOTE: The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

**Companies — Reorganization — Stockholders' meeting —
Proxies—Sanction of arrangement between company
and shareholders**

1. (Re: Langley's Ltd.)

Ontario Court of Appeal

Where an arrangement between a company and its shareholders was sought and a notice to shareholders stated that persons named in the form of proxy enclosed would vote in favour of the arrangement, as a result of which the holder of such proxies could vote only in favour of the arrangement, although he would have voted for a modification of the plan had he been able to do so, the meeting was held one not as contemplated by the Companies Act, as s. 64(2) contemplates approval of an arrangement "either as proposed or as altered" and there could be no real consideration at the meeting of any alteration of the plan; hence an order sanctioning the arrangement was vacated. Furthermore if the restriction in the proxy were considered a condition precedent to its use, it became part of it and was invalid as contrary to the provision in s. 52(4) of the Act that the proxy shall not contain anything but appointment or revocation of a proxy.—[1938] 3 D.L.R. 230.

2. (*Re: National Grocers Co. Ltd.*)

Ontario Supreme Court

The inclusion on the form of proxies sent to shareholders of notations to the effect that they should reach the company's head office at least 24 hours prior to the meeting and that proxies in favour of the persons whose names were printed in the form might be voted in favour of the proposed arrangement held to be contrary to the provisions of s. 52(4) of the Companies Act and to have vitiated the proxies and possibly influenced the result of the voting. (*Re Dairy Corporation of Canada Ltd.*, [1934], 3 D.L.R. 347, O.R. 436, referred to.)

A proposed arrangement although approved at a meeting of shareholders by more than three-quarters of the shares of common stock represented and by more than three-quarters of the shares of preferred stock represented was refused sanction of the Court as the figures lost significance because a substantial percentage of the common shares were held by persons who were also preferred shareholders and as it would be unfair and unreasonable to force the arrangement on dissenting shareholders in view of the incomplete information in the circular sent out by the company to common shareholders purporting to explain the proposed arrangement. (*Br. Am. Nickel Corp. v. M. J. O'Brien Ltd.*, [1927] 1 D.L.R. 1121, applied.)—[1938] 3 D.L.R. 106.

[Editor's Note: A reference to the above judgments was published in the April 1938 issue of THE CANADIAN CHARTERED ACCOUNTANT, pp. 290-294.]

**Income tax—Salary of deceased partner paid to executor—
Capital or income—Assessment of life-tenant**

(*Riddell v. Minister of National Revenue*)

Exchequer Court of Canada

A sum of money, representing the greater amount payable for six months after the death of a member of a partnership under the terms of an agreement for payment of a certain salary "during his lifetime and to continue for six months after his death," paid to the executor of his will upon death of said partner and treated as an accretion to

the capital of the estate is a payment in the nature of income but cannot be assessed as income of the widow who received only the revenue therefrom under the terms of the will. A clause in the will authorizing the executor trustee to decide whether assets or liabilities ought to be credited or charged to capital or revenue of the estate will not affect the Crown's rights.—[1938] 3 D.L.R. 424.

[Editor's Note: A reference to the above judgment was published in THE CANADIAN CHARTERED ACCOUNTANT for May 1938, pp. 391-394.]

(The summaries of the following three judgments have been taken from *Canada Law Reports*.)

Executors and Administrators—Action against administrator of deceased's estate for loss alleged to have been caused by failure to realize upon assets within reasonable time

(*Davis v. Auld et al.*)

Supreme Court of Canada

The appeal was from the judgment of the Appellate Division of the Supreme Court of Alberta, [1937] 3 W.W.R. 368, which, by a majority, reversing the judgment of Ives J., held the defendant (the present appellant), to whom had been granted letters of administration of a deceased's estate, liable, in an action brought by certain of deceased's next of kin to recover for loss alleged to have been caused by defendant's failure to realize within a reasonable time upon assets of the estate.

The deceased died, intestate, on June 15, 1929. Defendant applied for letters of administration on November 28, 1929. The judge's fiat for issue of grant was made on January 30, 1930. A lengthy delay occurred in settling the amount of succession duties, and, in consequence (by reason of the Rules of Court and the *Succession Duties Act*, Alberta), letters of administration (which recited the date of grant as of January 30, 1930) were not issued until November 6, 1931. The case was dealt with throughout on the assumption that the loss complained of could not be said to have been attributable to acts or omissions of defendant after the last mentioned date.

Held: That defendant's appeal be allowed and the judgment at trial (dismissing the action) be restored.—[1938] S.C.R. 304.

**Sales tax—"Goods manufactured and produced"—"Tires
manufactured by contract for labour only"
—Liability for taxes**

(Re Boulton Limited)

Exchequer Court of Canada

Defendant's business is that of retreading used automobile tires. Some of these tires are retreaded for customers to whom defendant returns the identical tires given it for treatment, the customer paying the usual charge for this work. Defendant also sells retreaded tires from stock to the public, and in other instances exchanges a retreaded tire from stock for an old tire, receiving as consideration the usual charge for retreading a tire.

Held: That where defendant retreads tires for customers to whom it returns the identical tires given it for treatment there is no liability for sales tax or excise tax.

2. That the tires defendant sells or exchanges from stock after retreading are "goods produced or manufactured" by defendant within the meaning of s. 86(1) (a) of the Special War Revenue Act (R.S.C. 1927, c. 179 and amendments) and are "tires manufactured or produced" by defendant within the meaning of s. 80 and schedule 11 (item 3) of the said Act; and defendant is liable to pay in respect thereof the sales tax and excise tax imposed by said sections accordingly. *The King v. Bilrite Tire Co.* [1937] Ex. C.R. 1 and [1937] S.C.R. 364 followed.—[1938] Ex. C.R. 187.

Sales tax—Property and civil rights—Ultra vires

(Re Imperial Tobacco Company of Canada Limited)

Exchequer Court of Canada

Section 119 of the Special War Revenue Act, R.S.C., 1927, c. 179, as enacted by 24-25 Geo. V, c. 42, s. 14, provides: "Everyone liable under this Act to pay to His Majesty any of the taxes hereby imposed, or to collect the same on His Majesty's behalf, who collects, under colour of this Act, any sum of money in excess of such sum as he is hereby required to pay to His Majesty, shall pay to His Majesty all moneys so collected, and shall in addition be liable to a penalty not exceeding five hundred dollars."

PERSONALS

Defendant company, a manufacturer, under colour of the statute, collected sums of money in excess of the amount which it was required to pay to His Majesty, in connection with goods produced or manufactured in Canada and also in connection with goods imported into Canada.

Held: That s. 119 of the Special War Revenue Act, R.S.C., 1927, c. 179, except the provision imposing a penalty, is *ultra vires* of the Parliament of Canada and consequently null and void.—[1938] Ex. C.R. 177.

PERSONALS

G. Harold Craig and Robert R. McDonald announce the dissolution of the firm of McDonald, Craig & Co., chartered accountants, Toronto, as of the 31st August 1938.

Robert R. McDonald and Sidney Edward Nicholson announce that they have become associated in partnership as of 1st September 1938, and that their combined practices will be carried on as heretofore under the firm name of McDonald, Nicholson & Co., chartered accountants, with offices at 350 Bay Street, Toronto.

G. Harold Craig and John F. Broadhead announce that they have become associated in the practice of their profession under the firm name of G. Harold Craig & Co., chartered accountants, with offices at 204 Victory Building, Toronto.

Messrs. Eric M. McCullagh & Co., chartered accountants, announce the removal of their offices to 902 Confederation Life Building, Winnipeg, Manitoba.

TERMINOLOGY DEPARTMENT

Further definitions of accounting terms will appear in the November issue.

OBITUARIES

The Late William Shaw Buttar, F.C.A.

The Institute of Chartered Accountants of British Columbia announces with deep regret the death at Vancouver on 25th August 1938 in his 71st year of William Shaw Buttar, F.C.A., a member of the Institute since 1906, and senior member at the time of his death.

Mr. Buttar was born 19th July 1867 at Corston, Coupar Angus, Scotland, and in 1885 was articled to Peter Ronaldson, C.A., Edinburgh, with whom he served for five years. In 1891 he was admitted to the Society of Accountants in Edinburgh, and in subsequent years was connected with the firms of Messrs. Davidson & Syme and Messrs. Moncrieff & Horsburgh, Chartered Accountants, in Edinburgh, following which he spent some time in India and South America.

Coming to Canada in 1905, Mr. Buttar practised for himself in Vancouver until the formation, in 1907, of the firm of Buttar & Chiene with whom, as senior partner, he was actively engaged up to the time of his death.

Mr. Buttar was keenly interested in anything pertaining to the profession and was ever willing to be of service to the Institute in British Columbia. The sincere sympathy of all members is extended to Mrs. Buttar, who is the sole survivor.

The Late J. Wilfred Boulet, C.A.

The Society of Chartered Accountants of the Province of Quebec regrets to announce the death at Quebec on 11th August 1938 of J. Wilfred Boulet in his fifty-first year.

The late Mr. Boulet was a partner in the firm of Boulet & Boulet, Quebec City, and had been a member of the Quebec Society since 1921.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

It can be argued that when the allottee of a subscription right sells that right he is realizing upon a portion of surplus which might otherwise have been made available to him in the form of a stock dividend, and that accordingly the proceeds of sale should be treated as income from investments. An accounting treatment which probably finds more general favour is that advocated by Finney¹:

The profit or loss on the sale of the right is determinable by apportioning the cost of the old stock between the right and the stock, on the basis of the market value of the right and of the stock ex-rights at the time of the issuance of the right.

Illustration—

Right sold for	\$30.00
Apportioned cost of right:	
Cost of share held	\$100.00
Market value of stock ex-right	120.00
Market value of right	30.00
30/150 of \$100.00	20.00
Profit	<u>\$10.00</u>

The sale of the right should be recorded as follows:

Cash	\$ 30.00
Stock Account	\$20.00
Profit on Sale of Right	10.00

The stock is retained, but its carrying value is reduced, by the \$20.00 credit, to \$80.00, or 120/150 of the original cost of \$100.00.

All past discussion of this topic is based on the assumption that the right is a device for facilitating new financing. Recently however there occurred an instance of its employment to adjust the respective interests of preferred and common shareholders in a company with a large accumulated deficit. This company was capitalized with preferred shares of \$100.00 par value (on which there were some \$40.00 of arrears of dividend) and with common shares of no par value. It was decided to offer to the preferred shareholders the right to purchase $2\frac{1}{2}$ shares of common stock at \$1.00 per share for each preferred share held. The exercise of the right was to liquidate

¹H. A. Finney, *Principles of Accounting*, Volume I, Intermediate, (Prentice-Hall), p. 331.

the arrears on the preferred stock. Immediately before the date of issue of these rights the preferred share was listed at \$78.00, the common at \$8.00; immediately after the issue the quotations were—preferred \$75.00, common \$8.00, rights \$17.00.

The question arises whether Finney's treatment is appropriate to these circumstances. Assuming an investor held a preferred share which he had bought for \$100.00 the entry would be:

Cash	\$17.00	
Loss on Sale of Right	1.48	
Preferred Stock Account ..		\$18.48

The carrying value of the share is thus reduced to \$81.52 so that if it were sold at \$75.00 a loss would be taken on it proportionate to the loss already taken on sale of the rights. We would value our readers' opinions on this procedure.

* * *

The June issue contained the published statements of a corporation in the Union of South Africa which we described as "typical" of South African practice. Our correspondent in that country writes to say that these statements are "probably not typical, but are instead, substantially better than average."

* * *

PUZZLE

A grocer weighed a bag of sugar for a customer on a pair of false scales on which it registered 45 lbs. The customer put the bag on the opposite pan of the scales and found that it now weighed only 20 lbs. What was the actual weight of the bag of sugar?

* * *

STUDENTS' ASSOCIATION NOTES

BRITISH COLUMBIA

The annual Field Day and dinner meeting of the Institute of Chartered Accountants of British Columbia, Students' Association, was held on September 2nd.

The Gyles-Foster golf cup was won by L. B. Boucher. Owing to the interruption of a thunder-storm, the tennis tournament was postponed to a future date.

Following the golf and tennis matches a dinner meeting was held at the Hotel Georgia, the guests for the occasion being Messrs. F. J. Grover, M. Crehan, F. Gordon-Cooper, C. J. Ferber, and P. Rising, all members of the Institute of Chartered Accountants of British Columbia.

At the dinner, the students learned with regret of the approaching departure of the president of the Society, Mr. Ken. Atkinson, who is leaving to take a position in Toronto.

The new council elected was as follows: A. F. Affleck, W. J. Barrett-Lennard, L. B. Boucher, J. Brown, J. A. McIntyre, B. W. Power, and S. E. Thorne.

ONTARIO

With the summer season well behind us, it is perhaps timely to turn our attention to the fall activities of the Students' Association—and the examinations looming on the not-too-distant horizon.

Realizing the benefits to be derived from the discussion of problems, the Students' Council are planning to arrange a series of study groups for the students of various years, as a supplement to the present course of instruction. This innovation has been enthusiastically received by a number of students, and the success of the groups under the leadership of competent instructors is assured.

Other meetings of a less academic nature have also been arranged, and the Students' Council extends a most cordial invitation to all chartered accountants to meet with the students and hear such men as Dr. W. A. Mackintosh, Mr. B. K. Sandwell and others. The time and place of these meetings will be announced by letter.

PROVINCE OF QUEBEC

During the coming Fall and Winter months Discussion Groups are to be organized in connection with the following subjects:

- (a) **BUDGETING:** Discussions dealing with the necessity of budgetary control, and its application and utility in modern business practice.
- (b) **COST ACCOUNTING:** A series of discussions on the theory and application of various phases of cost accounting.
- (c) **INCOME TAX:** A series of discussions dealing with the Dominion Income Tax Act, and some of the

problems encountered in preparing returns of various industries.

- (d) **PUBLIC SPEAKING:** A series of discussions on the fundamentals of public speaking and self-expression, and actual practice therein.
- (e) **REPORT WRITING:** Discussions of the best methods of preparing reports on various accounting activities, including investigations and reorganizations and the use and analysis of financial statements.
- (f) **INTERMEDIATE ACCOUNTING:** A series of discussions dealing with problems encountered by the student preparing for his Intermediate Examination, in connection with such subjects as Partnerships, Company Procedure, Elementary Costs, and the Comparison of Financial Statements.
- (g) **FRENCH-SPEAKING GROUP:** A general series of discussions intended particularly for French-speaking members, dealing with the theory and practical application of accounting subjects, such as Auditing, Investigations, Consolidated Statements, Report Writing, Income Tax, and other subjects which may be chosen by the Group.

* * *

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by a practising chartered accountant of the Institute from whose examinations the problem is taken and represent his views and opinions. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SASKATCHEWAN

FINAL EXAMINATIONS—NOVEMBER, 1937.

GENERAL AUDITING, QUESTION No. 1.

The Capitalistic Corporation is a holding company trying to secure control of a number of wholesale businesses by acquiring large blocks of shares in other companies. It has not yet secured any shares in Manalta Company Limited, but R. Thompson, a shareholder in this company, offers to sell his 2,000 shares at \$5.50 per share.

The Manalta Company's balance sheet is given below. There is no reason to question the valuation placed on buildings, equipment and stock. The net profits for the past four years, after charging interest on debentures, have been:

STUDENTS' DEPARTMENT

1933—\$2,570.00; 1934—\$2,170.00; 1935—\$2,460.00; 1936—\$2,095.00

You are engaged to report to the Capitalistic Corporation, discussing Thompson's offer and comparing same with your own valuation of the shares on

- (1) Balance sheet basis
- (2) Profits basis.
- (3) Profits basis, having regard to any additional capital that may be required.

Assume that companies, similar to the Manalta Company in size and type of business, require to earn 10% on their capital if their shares are to be quoted at par.

MANALTA COMPANY LIMITED, BALANCE SHEET AS AT DECEMBER 31st, 1936.

ASSETS		LIABILITIES	
Cash	\$ 195.00	Accounts Payable	\$33,125.00
Accounts Receivable	17,340.00	Reserve	10,000.00
Merchandise Stock	10,800.00	Capital Stock:	
Buildings	\$47,000.00	Authorized & Issued:	
Less 4% Debentures		5,000 shares of \$10.00 each—	
Payable 1940	32,500.00	\$5.00 paid up	25,000.00
	14,500.00	Profit and Loss	\$2,700.00
Equipment	9,000.00	Less Dividend 1936. 2,500.00	
Auto Trucks	8,500.00		200.00
Goodwill	7,500.00		
	<u>\$68,335.00</u>		<u>\$68,335.00</u>

The auditors' certificate states: "We have examined the above balance sheet with the books of the company and have obtained all information and explanations we have required. One of the book debts amounting to \$6,300.00 has been owing for three years and appears to be uncollectable. Subject to this, we are of the opinion that the balance sheet is properly drawn up so as to exhibit a true and correct view of the company's affairs according to the best of our information and the explanations given to us, and as shown by the books of the company. In our opinion, all the transactions of the company that have come to our notice, have been within the objects and powers of the company."

SOLUTION

It is suggested that the student will obtain greater benefit from the above problem if before reading any further, he carefully prepare an answer thereto. In the light of his own thoughts on the problem he may then consider the solution and comments submitted below.

In answering any problem the student does well to make sure (as he would in practising the profession) that he has all the necessary information. The examiner does not necessarily always give all of the required particulars.¹ The question states that "there is no reason to question the valuation placed on buildings, equipment and stock," but does not mention auto trucks or goodwill. The information given in the Auditors' report is, of course, reason to question the valuation of accounts receivable. The nature of the \$10,000 "Reserve" is not disclosed; it may represent an allowance for depreciation or, on the other hand, retention of profits for general or specific use—these are two natures of a vast difference.

Whether or not the Auditors' report is reliable is not directly disclosed by the question; however, the fact that such a report is ap-

pendent to a Balance Sheet which does not reveal the nature of a \$10,000 item (roughly 1/10 of total assets) nor the basis of asset valuations and records a liability as a deduction from a specific asset, should, it is believed, be a warning.

In such cases the examinee discloses the fact that he has a knowledge of what information he should look for by making the necessary assumptions² (that, for an example in this case, "it was found that the 'Reserve' represents an asset valuation account"), stating for the examiners' information the assumptions that he has made.

In answering the question now being dealt with, he might well point out (if he so concludes) that he does not believe the Balance Sheet can be relied upon, giving the reasons (as mentioned above), and further that if the statements and reports are not reliable he would, in practice, have to ask for instructions and authority to make an investigation in order to satisfy himself that his conclusions would be based on dependable information. If the request was not complied with, his report should be so qualified.

The knowledge of the amount of reported profits for four years is not sufficient on which to base a conclusion as to past earning power. Four years, particularly such as 1933 to 1936, is too short a period in which to determine the trend of a business. Further, unless given the Profit and Loss Statements and access to the records, the commentator can not assure himself as to how much of the stated earnings are regular operating profits or losses, as opposed to non-recurring and/or non-operating profits or losses, nor can he be assured that each figure is adjusted to show the profit accruing in the period it purports to cover.

The writer is not inclined to believe that the questioner intended that the answer be in three distinct divisions; i.e. "(1) Balance Sheet basis, (2) Profits basis etc."³

The Balance Sheet is a combination of figures not in excess of realizable values (current assets) and conventional figures (fixed assets) and as such does not purport to show even the present *actual value* of a business. The value of shares is determined by their earning power and not by their book "value." Past earning power is disclosed by the Profit and Loss Statements; but, in considering the probabilities of continuation of such power the present *position* of the concern, as disclosed by the Balance Sheet, must be taken into consideration as must any probable changes in financing.

The reasons for consolidations may be hoped-for: (1) monopolistic profits (2) increased profits through decrease of costly destructive competition (3) increased profits through an extension of large scale production (4) profits of promotion. It may be seen from this that, if the hopes were realized, the shares of a company would be worth more to a holding concern than they had been to the stockholders of that company as an independent unit. The relinquishing stockholder usually expects to profit by this fact; the commentator should therefore take these possibilities into consideration.

The Capitalistic Corporation wishes to "secure control" of the Manalta Company. Thompson offers 2,000 out of an issue of 5,000 shares—not a majority and hence not a controlling block, unless the remaining 3,000 shares do not all carry voting power. Could the Capitalistic Corporation secure the additional shares required, and if so at what price? The answer to that question has a bearing on the attractiveness of the offer at hand.

STUDENTS' DEPARTMENT

The above is intended as a discussion of the points which the examinee should take into consideration in tackling the problem—a discussion which takes much more time than would be required in the examination room to consider the problem, write down any necessary assumptions, make notations of limitations because of lack of information, and to proceed with the actual report.

Because of the above discussion italics have been used in the following report to indicate a point of assumption.

The Capitalistic Corporation,

Gentlemen:

The following comments on Mr. R. Thompson's offer of two thousand shares in the Manalta Company Limited at \$5.50 per share are based on the Balance Sheet and Profit and Loss figures submitted to us in your letter of January 31st, 1937, together with the information given in your February 3rd letter regarding the nature of certain Balance Sheet items. You will understand that, as we *could not* verify the Balance Sheet and Profit figures *nor* obtain particulars of the results of trading operations, we cannot be reasonably confident of the dependability of the basic information, nor can we make a proper analysis of the Manalta Company's past operations.

As *all* of the five thousand shares carry voting powers, the price at which you can acquire the additional shares (over and above the two thousand now offered), necessary to give you the desired control, should be taken into consideration. It is the average cost of all shares acquired, in relation to their earning power, in which you are mainly interested.

The market values for the *past few* years of shares in companies similar to the Manalta Company indicate that, due to the comparative risk involved, the shareholders expect to earn 10% per annum on their investment. It may be seen from Schedule B that on this basis the market value of the Company's shares would have been well below the figure at which the two thousand are now offered to you. Whether or not there have been any changes in the investment per share during the four years, which may have had some effect on profit fluctuations, we do not know.

On Schedule A we present a resulting Balance Sheet after making the explained adjustments to the statements submitted to us. It may be seen from this Balance Sheet that it will very probably be necessary to invest more capital in the business in order to place it in proper current financial position. The ratio of current assets to current liabilities at the present time as disclosed on Schedule A is roughly two to three, whereas the required ratio, judging from the average for successful businesses of the same size and line, is approximately two to one. The Company appears to be very short of cash and unable to pay its short term creditors: a position which would probably result in necessity of reorganization or bankruptcy if not corrected. An investment of the balance uncalled on outstanding shares will not, in itself, raise the current ratio above, roughly, 1.44 to 1.

It thus appears probable that a substantial call on outstanding shares will be necessary. A great deal at least of this further investment may only serve to maintain, and not to increase, past earning power, and hence if to be made after the shares would be transferred, the present value of those shares are correspondingly less than the values shown on Schedule B. Any further investment of

owners' or borrowed funds, which does not increase the earnings at least in proportion to the additional capital or at least equal to the cost of the loans, will decrease the percentage of shareholders' earnings. Yet, as has been pointed out, such further investment may be necessary to prevent a loss of past earning power.

In this regard it is to be noted that the debentures are payable in 1940 while no provision appears to have been made for their redemption. The probability of refunding this liability at the same effective interest rate or less must be considered.

Whether or not an improved current position of the Manalta Company and/or its being a subsidiary of your concern would result in an increase in earnings sufficient to make the investment worthwhile we cannot say. Judging from the comparatively little information we have at hand, we are not of the opinion that Mr. Thompson's offer presents the opportunity of a good investment. However, it is respectfully suggested that if the investment is to be further considered, an investigation be arranged for the purpose of ascertaining the nature of previous earnings of the Company (hence its past earning power) and trend thereof, together with more particulars of its present financial position.

Respectfully submitted,

Exhibit D

SMITH & JONES COMPANY

BALANCE SHEET AS AT JUNE 30th, 1936.

Current Assets:		
Cash on Hand	\$ 700.00	
Balance at Bank	4,000.00	
Trade Accounts Receivable	10,200.00	
Trade Notes Receivable	3,200.00	
Merchandise Inventory	8,000.00	
TOTAL ASSETS—Current	26,100.00	
Current Liabilities:		
Trade Accounts Payable		\$ 5,400.00
Trade Bills Payable		1,700.00
Bank Loan		5,000.00
TOTAL LIABILITIES—Current		\$12,100.00
Capital:		
A. Jones Capital Account,		
Jan. 1/36	\$2,500.00	
Current Account	2,187.50	4,687.50
B. Smith Capital Account,		
Jan. 1/36	7,500.00	
Current Account	1,812.50	9,312.50
TOTAL		\$26,100.00

NOTE: Assumed that Notes Receivable and Payable and Accounts Payable are on trade transactions, and that inventory figures include no consigned stock.

FOOTNOTES

1. A good example of this point may be found on the same paper from which the above problem has been taken. The seventh question reads "A company has Current Liabilities of \$77,000, Net Worth of \$300,000, Current Assets of \$157,000, of which \$118,000 is Merchandise Stock. Comment on its financial position." In the writer's opinion the examiner wished to ascertain whether or not the examinee had the knowledge to point out that he could not make an intelligent commentation on the basis of such meagre information and to list the more important, at least, of the additional facts he would wish to know.

2. Care must be taken to guard against the extreme of making unnecessary assumptions and altering the question.

3. In answering a similar problem one student stated in the first part that on the Balance Sheet basis the offer was a fair one, while in the second part that the offer was not a fair one on the profits basis. He made no attempt to reconcile one to the other and so to arrive at one conclusion on all proper bases; the question had not been answered.

PROBLEM II.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF
SASKATCHEWAN

INTERMEDIATE EXAMINATIONS, NOVEMBER, 1937

AUDITING, Question No. 8

The bookkeeper of a concern has made up the following interim statements of a business for the information of the partners. The partners, however, are not satisfied with the manner in which they are drawn up and are doubtful if the result shown is correct. You are requested to redraft the statements in presentable form should you find them to be incorrect. Interest is allowed partners on capital as at beginning of period at 5% per annum.

TRADING AND PROFIT AND LOSS ACCOUNT

Debits		Credits	
Purchases	\$27,000.00	Inventory January 1st,	
Inventory June 30th,		1936	\$ 8,250.00
1936	5,000.00	Sales	40,025.00
Partners' Drawings ...	2,500.00	Commission Earned ...	1,500.00
Rent	500.00	Interest on Capital ...	500.00
Salaries	1,500.00		
Wages	4,750.00		
General Expenses	900.00		
Interest on Loan	125.00		
Balance, Net Profit ...	8,000.00		
	<u>\$50,275.00</u>		<u>\$50,275.00</u>

BALANCE SHEET

JUNE 30th, 1936.

Debits		Credits	
Creditors	\$ 5,400.00	Customers' Accounts	
Notes Receivable	3,200.00	Receivable	\$10,200.00
Partners' Capital, July		Cash on Hand	700.00
1st, 1936	10,000.00	Cash in Bank	4,000.00
Net Profit	8,000.00	Bank Loan	5,000.00
		Inventory June 30th,	
		1936	5,000.00
		Bills Payable	1,700.00
	<u>\$26,600.00</u>		<u>\$26,600.00</u>

SOLUTION

Assumed that:—

- (1) There are two partners, A. Jones and B. Smith, sharing profits (after deducting capital interest) equally. Jones' capital account as at January 1st, 1936 \$2,500.00 and Smith's \$7,500.00.
- (2) Smith withdrew \$1,500.00 and Jones \$1,000.00.
- (3) There are no accruals or prepayments.
- (4) Commissions Earned represents the gross earnings, expenses being borne by the Partnership.

SMITH & JONES COMPANY

TRIAL BALANCE AS AT JUNE 30th, 1936.

	Dr.	Cr.
Purchases	\$27,000.00	
Current Accounts, A. Jones	1,000.00	
B. Smith	1,500.00	
Rent	500.00	
Salaries	1,500.00	
Wages	4,750.00	
General Expenses	900.00	
Interest on Loan	125.00	
Inventory, Jan. 1st, 1936	8,250.00	
Sales		\$40,025.00
Commission Earned		1,500.00
Interest on Capital	500.00	
Creditors		5,400.00
Notes Receivable	3,200.00	
Capital Accounts—A. Jones		2,500.00
B. Smith		7,500.00
Customers Accounts Receivable	10,200.00	
Cash on Hand	700.00	
Cash in Bank	4,000.00	
Bank Loan		5,000.00
Bills Payable		1,700.00
	<u>64,125.00</u>	<u>63,625.00</u>

STUDENTS' DEPARTMENT

Assumed that Capital Interest (5/100 of 10,000 x $\frac{1}{2}$ = 250.00)		
debit and credit entry amounts are included in the above "Interest on Capital—\$500.00"		
Therefore to adjust Interest on Capital—Less	250.00	
To Current Accounts—A. Jones		62.50
B. Smith		187.50
	<u>\$63,875.00</u>	<u>\$63,875.00</u>

Exhibit A

SMITH & JONES COMPANY

TRADING STATEMENT FOR THE SIX MONTHS ENDED JUNE 30th, 1936.

Sales		\$40,250.00
Less: Cost of Sales:		
Inventory as at January 1st, 1936	\$ 8,250.00	
Purchases	<u>27,000.00</u>	
	35,250.00	
Less: Inventory as at June 30th, 1936	<u>8,000.00</u>	27,250.00
Gross Trading Profit on Sale of Own Stock		12,775.00
Commission Earned on Consignment Sales		<u>1,500.00</u>
Gross Trading Profit on All Sales		14,275.00
Trading Expenses:		
Salaries	1,500.00	
Wages	4,750.00	
Rent	500.00	
General Expense	<u>900.00</u>	7,650.00
Net Trading Profit to Exhibit B		<u>\$ 6,625.00</u>

Exhibit B

SMITH & JONES COMPANY

PROFIT & LOSS STATEMENT FOR THE SIX MONTHS ENDED JUNE 30th, 1936.

Net Trading Profit as per Exhibit A	\$6,625.00
Less: Interest on Bank Loan	<u>125.00</u>
Net Profit to Exhibit C	<u>\$6,500.00</u>

Exhibit C

SMITH & JONES COMPANY

PROFIT AND LOSS APPROPRIATION FOR THE SIX
MONTHS ENDED JUNE 30th, 1936.

Net Profit		\$ 6,500.00
Less: Interest at 5% per annum on Capital Accounts		
A. Jones	\$ 62.50	
B. Smith	187.50	250.00
		<u>6,250.00</u>
To A. Jones Current Account	3,125.00	
B. Smith Current Account	3,125.00	
	<u>\$6,250.00</u>	<u>\$6,250.00</u>

A. JONES CURRENT ACCOUNT

Interest on Capital Six Months ended June 30th, 1936	\$ 62.50
Share of Net Profit for Six Months ended June 30th, 1936, after deducting Capital Interest	3,125.00
	<u>3,187.50</u>
Less: Withdrawals	1,000.00
	<u>\$2,187.50</u>

B. SMITH CURRENT ACCOUNT

Interest on Capital Six Months ended June 30th, 1936	\$ 187.50
Share of Net Profit for Six Months ended June 30th, 1936 after deducting Capital Interest	3,125.00
	<u>3,312.50</u>
Less: Withdrawals	1,500.00
	<u>\$1,812.50</u>

